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USE OF TAX REFUND OFFSETS TO COLLECT NONTAX FEDERAL DEBTS

M 118

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

FIRST SESSION

SEPTEMBER 19, 1985

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USE OF TAX REFUND OFFSETS TO COLLECT NONTAX FEDERAL DEBTS

THURSDAY, SEPTEMBER 19, 1985

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:07 a.m., in room 2161, Rayburn House Office Building, Hon. J.J. Pickle (chairman of the subcommittee) presiding.

[The press release announcing the hearing follows:]

[For immediate release Friday, Sept. 13, 1985]

HON. J.J. PICKLE (D. TEX.), CHAIRMAN, SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES A HEARING ON THE USE OF TAX REFUND OFFSETS TO COLLECT NONTAX FEDERAL DEBT

The Honorable J.J. Pickle (D., Tex.), Chairman of the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, announced today that the subcommittee will hold a hearing on the current status of the Treasury Department's pilot program for collecting nontax debts owed to Federal agencies by offsetting tax refunds against these debts. The subcommittee will specifically focus on the effect this program might have on Federal agencies, taxpayers, and the tax system as a whole.

This hearing has been scheduled for Thursday, September 19, 1985, in room 2261, Rayburn House Office Building, beginning at 10 a.m. The subcommittee has requested that the Commissioner of the Internal Revenue Service appear as a witness at the hearing, and has invited testimony from representatives of the Department of Education, the Department of Agriculture, the Department of Housing and Urban Development, the Small Business Administration, and the Veterans Administration. In addition, the Subcommittee will receive testimony from the public concerning past experiences and future concerns connected with this refund offset program.

In announcing this hearing, Chairman Pickle stated, "People who borrow from the Federal Government should repay their loans, and the Government should vigorously pursue those who do not. It is for this reason that the Congress has authorized the Secretary of the Treasury to test, on a 2-year limited basis, the use of tax refund offsets for collecting these debts. However, in our zeal to collect these debts through use of the extraordinary powers granted to the Internal Revenue Service, we must be sure that we do not undermine public support for our tax system. The Congress must carefully evaluate this 2-year program in comparison with alternative approaches before deciding to permit the use of tax refund offsets on a permanent basis."

BACKGROUND

The Deficit Reduction Act of 1984 amended section 6402 of the Internal Revenue Code to provide that for a 2-year period the amount of any refund of Federal taxes is to be reduced by the amount of any certified debt owed to the Federal Government. This program is to be operated by the Secretary of the Treasury. The Secretary is authorized to test the refund offset procedures with selected agencies before fully implementing the provision. The purpose of the 2-year period is to allow examination of the extent to which tax refund offsets facilitate and increase the amount

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of debts collected, and the effect tax refund offsets have on taxpayer compliance with the income tax law. This provision becomes effective on January 1, 1986, and will expire on December 31, 1987.

DETAILS FOR SUBMISSION OF REQUESTS TO BE HEARD

Individuals and organizations interested in presenting oral testimony before the subcommittee must submit their requests to be heard by telephone to Harriett Lawler (202) 225-3627, no later than close of business Tuesday, September 17, 1985, to be followed by a formal written request to Joseph K. Dowley, chief counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, DC 20515. The subcommittee staff will notify by telephone those scheduled to appear as soon as possible after the filing deadline. Any questions concerning a scheduled appearance should be directed to the subcommittee staff (202) 225-5522.

Since the time available for the hearing is limited, it is urged that persons and organizations having a common position make every effort to designate one spokesperson to represent them in order for the subcommittee to hear as many points of view as possible. Time for oral presentations will be strictly limited with the understanding that a more detailed statement may be included in the printed record of the hearing. This process will afford time for Members to question witnesses. In addition, witnesses may be grouped as panelists.

All witnesses scheduled to appear before the subcommittee are required to submit 100 copies of their prepared statements to the subcommittee office, 1105 Longworth House Office Building, by the close of business, Wednesday, September 18, 1985. Failure to comply with this requirement may result in the witness being denied the opportunity to testify in person.

Requests to be heard, prepared statements to be presented in person, and statements filed for the printed record of the hearing, must contain the following information:

(1) The name, full address, and capacity in which the witness will appear (as well as a telephone number where the witness or a designated representative may be reached).

(2) A list of any clients or persons, or any organization for whom the witness appears; and

(3) A topical outline or summary of comments and recommendations.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE

Persons submitting a written statement for inclusion in the printed record of the hearing should submit at least six copies by the close of business, Friday, September 27, 1985, to Joseph K. Dowley, chief counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, DC 20515. (See other requirements enumerated above.) If those filing a written statement for the printed record of the hearing wish to have their statement distributed to the press and the interested public, they may provide 100 additional copies for this purpose to the subcommittee office, room 1105, Longworth House Office Building, Washington, DC 20515, before the hearing begins.

Chairman PICKLE. I understand that a member of the minority is on the way, and I am going to proceed with making an opening statement, in the interest of time.

In the hearing this morning, the members of the Oversight Subcommittee will be reviewing the administration's current plans for testing the overall effectiveness of using tax refund offsets to collect debts owed to the Federal Government.

The need to address the problem of nonrepayment of Federal loans is clear. Millions of people have benefited from loans extended to them on very generous terms by the various Federal agencies, and yet many of these loans have not been repaid. This results in the undermining of public support for these programs. Furthermore, the Federal Treasury stands to lose many millions of dollars at a time when it can ill afford any loss of revenue. So let the record be clear; people who borrow from the Federal Govern-

ment must expect to repay these loans, and the Government will vigorously pursue those who do not.

The question before us is not whether to seek repayment, but how best to achieve it? One approach is to say to those who owe the Government money and claim a refund on their taxes: "You should not expect to be paid money owed you, when you do not repay the money you owe the Government." This is the theory supporting the use of tax refund offsets to collect nontax Federal debts. This approach is made even more attractive because it enlists the aid of the Internal Revenue Service and its broad financial enforcement powers, in the effort to collect these debts.

However, in our zeal to collect these debts through use of the special powers granted to the Internal Revenue Service, we must be sure that we do not create even greater problems. Involving the Federal Internal Revenue Service in ventures not connected with the tax system is a matter that many find troubling. It is critical that this program not be used to circumvent the due process protections we all enjoy. It is also important that the process of collecting debts not be allowed to impair the Internal Revenue Service's primary mission of collecting taxes. That is the thing we have got to keep in mind. We must be careful to ensure that the Internal Revenue Service does not become a super Government agency or the tool for enforcing all of our Federal laws.

For these reasons, the Congress, in the Deficit Reduction Act of 1984, directed that there be a limited test of tax refund offsets. The Secretary of the Treasury is authorized to issue regulations implementing this program for a 2-year period, on a limited basis, with selected agencies. During this time, the program should be evaluated to learn the extent to which it facilitates the collection of debts owed the Federal Government and increases the amount of the debts collected, as well as to determine the effect of this provision on taxpayer compliance with the income tax laws in general.

It is often said that "nothing is certain but death and taxes." However, given the snafus connected with implementing the new IRS computer systems and the mystery surrounding the congressional tax reform process, there is precious little which is certain about our taxes. This lack of certainty is very unsettling to the public and erodes their confidence in our tax system. Therefore, we must all strive to minimize this uncertainty by proceeding cautiously in implementing and evaluating this new program.

Now, the witnesses with us this morning have all given considerable thought to the potential benefits and pitfalls of this program. I welcome their testimony and look forward to hearing their thoughts on how we should proceed in this process.

Our first witness this morning is Hon. Roscoe Egger, Jr., Commissioner of the Internal Revenue Service. And we are very pleased that you would take your time to be with us this morning and to express your opinion on this very vital subject.

We are going to move forward even though we do not have the other members, so we are going to ask you to proceed, Mr. Egger. We welcome you.

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STATEMENT OF HON. ROSCOE L. EGGER, JR., COMMISSIONER OF INTERNAL REVENUE

Commissioner EGGER. Thank you, Mr. Chairman.

I am pleased to be here today to talk about this whole business of the collection of nontax debts through offset of tax refunds. I will talk briefly about the current program of collecting past-due child and spousal support by the refund offset system as well as the expansion of refund offset under the Deficit Reduction Act of 1984 and the Child Support Enforcement Amendments of 1984.

I have here with me today, Mr. Chairman, Service officials who are fully familiar with all of the operational aspects of the debt offset program, and I believe that among us we can respond to just about any question that you or the members may have today.

For purposes of this testimony, I will refer to the programs involved as refund offset programs. Although the technical term for the amount offset is overpayment. I will use the more familiar term "refund." There is a potential technical distinction between the terms "overpayment" and "refund" that I will talk about just a bit later in my statement.

The broad outline of refund offset programs is simple. A given individual may owe a debt to a Federal agency, a State agency or to a private person. If that same person has an income tax refund due from the Federal Government, a refund offset program can capture the refund before it is paid to the individual and issue the amount to the individual's creditor.

THE CURRENT REFUND OFFSET PROGRAM (CHILD AND SPOUSAL SUPPORT)

Refunds have been offset for Federal tax liabilities for a number of years. However, the first effort to capture a pending refund for a nontax debt involved reimbursement to the States for certain child and spousal support expenses.

The Government's first nontax refund offset effort was instituted as part of the Omnibus Budget Reconciliation Act of 1981. The act, effective on October 1, 1981, provided in general that individual income tax refunds could be offset to the extent of certain delinquent child and spousal support obligations. Data on the individuals involved, the existence of these obligations, and the amounts to be offset are validated by the States and sent to the Office of Child Support Enforcement of the Department of Health and Human Services. HHS then forward this information to the IRS. We began offsetting refunds under this program in January 1982.

While the amounts offset represent child and spousal support obligations, the funds collected through offset are paid to the States, not to the child or spouse of the debtor-taxpayer. The program is not intended to transfer support to the child or spouse; rather, the program is designed to reimburse States for amounts of aid to families with dependent children payments which have already been paid to the child or spouse of the debtor-taxpayer. As a part of the process to qualify for AFDC, individuals assign to the State their rights to support.

The number of offsets and the amount collected has increased each year. In the first year of the child and spousal support pro-

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gram, the Service made some 279,000 offsets, with resulting payments of about $174 million. In 1983, more than 339,000 offsets were made with payments exceeding $178 million. Over 423,000 offsets were made in 1984, collecting over $210 million in past-due support. As of September 1 of this year, over 471,000 offsets have been made in 1985, resulting in payments of $229 million.

While the total amounts offset have increased, the average individual offset amount has been decreasing each year. These amounts decreased from $624 in 1982 to $526 in 1983, and to $498 in 1984. And as of September 1, the average offset amount for this year is $486. In addition, while the total number of offsets has increased, the percentage of cases referred to us in which an offset can be made has decreased from 51 percent in fiscal year 1982 to 41 percent so far in fiscal 1985.

Under the current program, the Service is reimbursed by HHS for the costs it incurs. In 1982, the Service was reimbursed by HHS at the rate of $17 per case. This figure has decreased every year, to $11 in 1983, to $3.20 in 1984 and 1985. The cost of offsetting the refunds decreased in 1984 and 1985 due to the installation of an automated method of withholding the refunds.

As in any program of this size and complexity, some errors are bound to occur. When disputes do arise, the Service refers the taxpayer to HHS which certified the debt to us originally. This referral is made because the IRS has no independent method of verifying the taxpayers' claims.

REFUND OFFSET UNDER THE 1984 CHILD SUPPORT ENFORCEMENT AMENDMENTS

Now, thus far I have described the child and spousal support program authorized by pre-1984 law. Last year, in section 21 of the Child Support Enforcement Amendments of 1984, Congress authorized a 5-year test extending the refund offset program to non-AFDC situations. This new authority will be effective for refunds issued after December 31, 1985. This extension is particularly significant because it means that for the first time, the Service will be acting in the interests of a private individual, that is, the person owed the unpaid child support, and not a governmental entity.

From an operational standpoint, we expect the new program to operate just as the AFDC Program I have described. That is, from the IRS perspective, our dealings will be with HHS, and HHS, in turn, will deal with the various State authorities. The Internal Revenue Service will be reimbursed for costs involved in this program, as we have in the past.

NEW REFUND OFFSET PROVISIONS—DEFICIT REDUCTION ACT

In addition to the child support extension, section 2653 of the Deficit Reduction Act of 1984 mandates that the Service conduct a 2-year test of collecting nontax Federal debts through the offset of income tax refunds. This section requires that the Internal Revenue Service:

One, reduce the amount of any refund otherwise payable to a taxpayer by the amount of any past due legally enforceable debt owed to a Federal agency of which the Service has been notified;

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Two, pay the amount of the reduction to the agency to which the debt is owed; and

Three, notify the taxpayer that the overpayment has been reduced.

A tax refund will not be withheld by the IRS for a nontax Federal debt until the Federal agency that is owed the debt has taken the following steps. First, the agency must notify the debtor that it is proposing to refer the debt to the IRS, and that the IRS will offset against any tax refund that may become payable. Second, the debtor must be given 60 days to present evidence that the debt is either not past due or not legally enforceable. The agency must consider any evidence submitted in evaluating the validity of the debt. Also, the IRS is considering a number of other criteria that must be satisfied before the debt is eligible for offset.

For the purposes of this 2-year test program, the Commissioner of Internal Revenue will identify those creditor Federal agencies that are eligible to participate in the offset program. We have selected five agencies to participate in the first year of the test, subject to final criteria being established. As has been reported in the media, the Department of Education will be one of the participants. Over $1 billion is owed to this single agency by more than 1 million people who have defaulted on various student loan programs.

As is the case with other offset programs, the Service will be reimbursed by each agency for which debts are collected.

JOINT RETURN PROBLEMS

In some instances, the refund that is offset will be from a joint return filed by a debtor-taxpayer whose spouse is not legally liable for the debt. In the event all or part of the refund belongs to the nonobligated spouse, that spouse can file an amended return—form 1040X—with the Service for his or her part of the refund. The Service will allocate, that is, divide, the couple's refund if the taxpayer provides the information necessary to allocate income and deductions on the joint return, so that each spouse's tax liability can thus be calculated. Taxpayers are advised of this procedure when they are notified of a refund offset.

In other instances, the taxpayer simply does not owe the amount claimed by the agency. In these cases, the IRS will refer the taxpayer to the agency for resolution of the controversy.

REFUND VERSUS OVERPAYMENT

As I mentioned earlier, there may be a technical distinction between the terms "refund" and "overpayment." Courts have reached conflicting results over the definition of "overpayment" and "refund." The issue here involves whether the offset applies to only the amount of the income tax withheld or whether it also applies to the refundable earned income credit. In one case, *Nelson* v. *Regan*,[1] the Second Circuit Court of Appeals determined that the

[1] *Nelson* v. *Regan*, F31 F.2d 105, 112 (2d cir.), cert. denied subnorm. *Manning* v. *Nelson*, U.S. 105 S.Ct. 175 (1984).

earned income credit cannot be subject to an offset. The opposite result was reached by the Ninth Circuit in *Sorenson* v. *the Secretary of the Treasury,*[2] in which the court concluded that the earned income credit is part of a refund and can be offset under the program. The Supreme Court recently granted certiorari in the *Sorenson* case, but has not rendered a decision on it to date. In the event the Government does not prevail in the *Sorenson* appeal, the committee may wish to consider corrective legislation.

From a purely administrative standpoint, the inclusion of the earned income credit as a part of the overpayment is somewhat more administrable. However, the real administrative problem is twofold. First, the current split in authority forces us to use one set of rules in one part of the country and another set in the rest of the country. Second, we will face a very substantial administrative problem in reversing earlier offsets if the ultimate result is the exclusion of the earned income credit from offset. If the decision is made to exclude the earned income credit from offset by statute, that decision ought to be prospective in nature.

TAX ADMINISTRATION CONCERNS

As we have previously communicated to this subcommittee, the Service has serious concerns about the refund offset mechanism's potentially adverse impact on the tax system. In 1984, we published the results of a preliminary study that indicated that persons who were subject to offset were twice as likely to become nonfilers in the succeeding year and three times as likely to have an income tax delinquency as persons who were not offset. The Service is currently updating the preliminary 1984 study. While our work is not yet final, the tentative result is that our 1984 study is being confirmed.

Some have argued that the nature of child and spousal support obligations make this group of debtors a unique class. The argument goes on to suggest that research on this group is of limited value for predicting behavior of persons offset for other kinds of debts. Frankly, we have no basis to know if this argument is correct or not.

It is our belief that most taxpayers proceed on the assumption that the information on their tax returns is confidential and will not be pulled from their returns and used against them in a nontax matter. The fact that offset programs are authorized by Congress and are entirely legal is of little consequence to these taxpayers; they still may feel it somehow violates their trust in the tax administration system. This attitude, right or wrong, is very real.

While the tax administration concerns are predominant in our minds, at the same time we recognize the need for strict fiscal discipline within the Federal system. If refunds can be offset without severe tax collection consequences, the program should be extended and expanded. Consequently, the Service supports the Federal debt offset program for its limited test period. We hope that during this period the Service will be able to collect the data needed to permit the Congress to make an informed judgment about the program.

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[2] 752 F.2d 1433 (1985).

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Mr. Chairman, I appreciate the opportunity to present my comments on this important topic. And as I said, my associates and I will be pleased to try to answer any questions you or members of the subcommittee may have.

Chairman PICKLE. We thank you, Mr. Egger. I think we all agree that this is a very serious and difficult problem to know how to handle it. Somehow, the Congress and the agency must agree on a policy that seems to be workable.

Let me ask a few questions about your testimony. On page 4 you said, "While the number and total amounts offset have increased, the average individual offset amount has been decreasing each year." Why is that?

Commissioner EGGER. We have tried to explore that ourselves, Mr. Chairman. We are not sure whether it is because of the fact that the offset program so far only affects the AFDC program and that there was possibly a kind of an inventory, if you will, or backlog of cases built up in those early years and that we have worked through those, or whether it is because people are adjusting their withholding. Probably all of those factors apply to some degree or other.

Chairman PICKLE. That may be the reason for it, because the inventory is being worked down.

Commissioner EGGER. Yes.

Chairman PICKLE. All right. On page 6 you describe the program saying that the offset provisions apply to a certain amount, and that we have a 2-year test that has been authorized.

The first point you make, you said you "reduce the amount of any refund otherwise payable to a taxpayer by the amount of any past-due legally enforceable debt owed to a Federal agency."

Now, if you offset, is it a complete offset? If an individual owes the Government $3,000, and you offset it, would you offset the total amount? Say a loan to a student who has borrowed $5,000 or $3,000 has not paid. If there is an offset, would it be for the total amount or would the individual be given a chance to pay it out on some kind of basis, or is it totally deducted?

Commissioner EGGER. What we will offset is what the agency certifies to us, Mr. Chairman. If the agency works out a installment arrangement with the individual and certifies only, you know, some of the installments to us, that is all we will——

Chairman PICKLE. You do not try to pass judgment; whatever amount comes from the agency, that is what you offset.

Commissioner EGGER. That is correct.

Chairman PICKLE. That amount.

Commissioner EGGER. Exactly.

Chairman PICKLE. What are the five agencies that will be selected for this test program? Have they been listed?

Commissioner EGGER. Yes. I have them here. I think they have been published.

As I mentioned, the Department of Education, of course, that has been in the press, but we also have Housing and Urban Development, Veterans' Administration, Small Business Administration, and the Department of Agriculture. These are the agencies that have been selected.

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Chairman PICKLE. I presume they will all be testifying today. Is that correct?

Commissioner EGGER. These are the agencies that have been selected, right.

Chairman PICKLE. Do you have a recommendation for us with respect to whether the earned income credit would be subject to an offset? Do you have a specific recommendation? You said perhaps a legislative action would be necessary.

Commissioner EGGER. That is in the courts, and the issue is going to the Supreme Court since there is a conflict in the two circuits. Our recommendation would be that if the Supreme Court should decide that it should not be offset, that any legislation make it prospective simply because the administrative problem would be staggering.

Chairman PICKLE. I think I would make this observation or at least you could comment on it. In the first place, the Congress has approved this program for the purposes of testing.

Commissioner EGGER. Right.

Chairman PICKLE. It is clear that that is what they are trying to do. We have not made it a permanent program; it is supposed to be an examination and a test, a demostration.

Commissioner EGGER. It is clear that it is a test program.

Chairman PICKLE. That ought to be kept in mind, and now as we go along, we ought to gather as much information as we can. But it ought to be understood this is not a permanent program yet. We are trying to test it. Is that where you are ready to use it?

Commissioner EGGER. Yes, sir. That is my understanding of what the Congress had in mind. They wanted very much to be sure that there were not long-range negative impacts on the tax system as a result, and that is why the test period.

Chairman PICKLE. The IRS, then, is clarifying the law, and testing will take place, and you have, what, a 2-year test?

Commissioner EGGER. Yes, sir. We have a 2-year test, and we will be tracking the results of the offset program throughout that 2-year period and providing an analysis just as quickly as we can.

Chairman PICKLE. One last question. Do you think that the Internal Revenue, although you are carrying out the full mandate of the Congress and in proper spirit, do you think that this should be a regular, permanent program as a means for the government to just automatically use the IRS to collect bad debts? Or do you feel that the Internal Revenue Service should be used only as a last resort in the collection of these debts?

Commissioner EGGER. Well, I certainly hope that the rules that ultimately evolve will place the burden fully on each of the agencies to make every effort to collect these debts themselves and that the refund offset be a last resort. I have no prejudice against having this as a continuing program once, I think, we have enough data to make an informed analysis as to what the full impact may be on the system in the long run.

Chairman PICKLE. Thank you, Mr. Commissioner.

Mr. Thomas, questions?

Mr. THOMAS. Yes. Thank you.

Mr. Commissioner, it is good to see you again. I do not want to dwell on the past in terms of the previous meetings we have had

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regarding computer problems and related subjects. But obviously, this is an added burden.

Have you seen any preliminary information about people who do not understand what is happening to them and who try to get in touch with the IRS for explanations? Has it overloaded your system?

Commissioner EGGER. Right. We got a fairly high percentage of calls from the taxpayers whose refunds are, in fact, offset. Many of them did not understand it; others want to debate the issue, et cetera.

In the first year, I think, in the case of the child care and spousal support offset, many of those callers were quite prepared to, you know, try to do battle with the Internal Revenue Service, but we have pretty well perfected the technique of referring them right back to HHS or to the State agency involved to deal with them. So while we got a pretty high percentage of those, those calls tend to be very short term, merely to provide them with not only the State agency but a telephone number and so on of people that they can reach.

Mr. THOMAS. From your testimony it is clear that the system is being perfected because of the cost per complaint is going down in a significant——

Commissioner EGGER. We were able to automate the system so that as of now the cost is just slightly over $3 per case.

Mr. THOMAS. Would you comment on the length of the 2-year test period? It appears to me that it takes a year or so for people to become aware of what is happening to them. They have to get at least one tax return back, preferably two. Then you always have the reaction to the new change; namely, game playing of the system; that is, they attempt to adjust, whether legally or illegally, and then you resort to enforcement procedures, if, in fact, their adjustments are illegal.

Does not all of this take considerably more than just 2 years to work itself out in order to assess whether or not there are long-term effects on the system?

Commissioner EGGER. I think, to begin with, the way the mechanics of the 1984 tax changes are going to work out, we will be offsetting in 1986 and 1987 for the 1985 and 1986 tax years, essentially. The difficulty is that by the time we can analyze all of the data, we are going to be near the end of calendar 1988. And I am not sure that we should have the taxpayers sort of standing on one foot and then the other, not knowing whether there is going to be an offset program in that year. So it may well be that even before we get to 1988 we will have to take another look at extending the offset period.

Mr. THOMAS. Do you see what I am saying? Perhaps a little longer time may be necessary for the program than is currently——

Commissioner EGGER. Yes, because we cannot—you see, the second year's tax returns will not even be offset until the program has come legally to an end.

Mr. THOMAS. So when we talk long term, 2 years certainly is not long term.

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Commissioner EGGER. Well, a 2-year test is not bad, but I think it does leave the taxpayers out there kind of hanging on a limb, wondering what is going to happen next.

Mr. THOMAS. Can you make any comments about the responses so far in terms of taxpayer reaction? You made some, and I want to make sure I am clear on that.

Commissioner EGGER. Well, the only one we got, of course, is the AFDC families. We can generalize in this sense that, No. 1, the effectiveness of the program seems to be disappearing. I say disappearing, but certainly going down because of all the cases that are referred to us now, a very, very much smaller percentage are actually offset and payments received.

By the same token, the number of cases referred to us on a kind of a percentage basis continues to stay high. So I think what we are having here——

Mr. THOMAS. Of course, in the new program, there will be a much better, if you will, cross section of taxpayers——

Commissioner EGGER. Fully different.

Mr. THOMAS. And any arguments that would be attributed to that particular group, we will have to wait and see the results.

Commissioner EGGER. That is correct. We are trying, you know, not to try to forecast what this group's reaction will be until we have collected more data here.

Mr. THOMAS. Are the responses largely legal or illegal on the part of the taxpayers?

Commissioner EGGER. They are largely uninformed, that they do not know it and so on. But we are doing our best to stay out of that.

Mr. THOMAS. Do they modify their returns the following year?

Commissioner EGGER. Well, we get all kinds of things. Number one is we are getting a higher percentage of nonfilers, so we have to go search out the file.

We are also getting instances which are being followed up by our examination people, where it is pretty obvious that taxpayers are claiming dependent's deductions to which they are not entitled, and so that is an operational phenomenon that is a follow-up.

But I would say that based on our observations, the debtors are filing differently with us. Either they are not filing or more likely to become balance due.

Mr. THOMAS. One of the reasons for a longer test period involves the reaction of taxpayers. There are those who are engaged in illegal activities, obviously, and the system will catch up with them. The extra burden of policing folks who otherwise would otherwise have minimally continued to file does not seem desirable.

One of the difficulties that, I think, we have is a notion that people will file if we make significant changes in the system. They do not file at a 70 percent tax rate, but if it were 50, they would. They did not file at 50, and now the argument is if we go to a 35 percent rate, they will file. My belief is they will file when it is zero, because they are not paying anything now.

Similarly, when you get into these circumstances, once people realize that they do not have certain avenues like not filing. Instead, they will exercise their legal choices, which is to be much more precise in terms of the amount that they withhold. And frankly, I

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hope they are not going to be the basis of arguments for IRS, that people are becoming more sophisticated. In other words, we do not want them to become aware of what they can and cannot do, because the Government can take advantage of those who lack knowledge of our tax laws. If they are sloppy, the Government can succeed, but if we have sophisticated taxpayers, we cannot, because our margin of difference is the lack of knowledge on the part of taxpayers. I hope that does not crop up as one of the explanations of why this is not a good system. I just want to give you that forewarning.

Commissioner EGGER. That will not be part of our debate. Let me assure you that we go out of our way to give taxpayers the information that they need in order to adjust their withholding properly. If anybody is going to make a judgment different than that, it will be the Congress and not the Internal Revenue Service.

Mr. THOMAS. Well, they are not getting the information from the telephone numbers provided to call, because they cannot get through. Perhaps, when they seek one-to-one counseling for an explanation of what is happening to them, the information will be available.

Thank you very much.

Chairman PICKLE. Before I recognize Mr. Anthony, can you tell us which of these five agencies or the programs involved are the largest violaters? That is, who are the biggest debtors?

Commissioner EGGER. In terms of numbers, Mr. Chairman——

Chairman PICKLE. Is it HUD, Education, student loans, the VA, SBA, or Agriculture—in order of either the dollar or the volume?

Commissioner EGGER. I think both in terms of the total dollar volume and in terms of the numbers, Education is pretty far out in front.

Chairman PICKLE. By Education, you are talking about student loans?

Commissioner EGGER. Student loans, basically. They have something in the neighborhood of $1 billion of past-due debts——

Chairman PICKLE. $1 billion

Commissioner EGGER. Yes, sir, owed by about 1 million people. So as you can see——

Mr. ANTHONY. Would the Chair yield at that point?

Chairman PICKLE. Yes, in just one second.

Did you have any other comments on that? What is your other order, and then I will recognize Mr. Anthony.

Commissioner EGGER. I am not sure I have that detail here. Let me check on that.

Chairman PICKLE. Well, could you give it to us as we go along? I would like to know what seems to be the area of the biggest concern.

I have been given an attachment here, which shows the various agencies. For the record, let me just make reference to it.

"Preliminary analysis of the numbers and volumes of debt currently being considered are the following." For the Department of Agriculture, the number of loans would be 37,000; the dollar volume of loans in billions is $0.161. I will have to get somebody to interpret that.

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The Department of Education is 1,400,000 and the dollar volume is $1.4 billion.

And Housing is 29,000; Small Business, 44; the Veterans' Administration is 798.

So it seems to be then that your two biggest categories would be the Department of Education, in the area of student loans, and the Veterans' Administration.

Mr. ANTHONY. Would the Chair yield at that point?

Chairman PICKLE. Now I yield to you, Mr. Anthony.

Mr. ANTHONY. I think you have got to take a different look at the way you make those calculations, and correct me if I am wrong. I did a little work on it last night, and I found HUD to be the biggest violator.

The numbers I used were 25,000 debtors divided into $146 million, and I come out with $5,840 as an average loan.

Now, you are using 29,000 as the number of loans, and the same amount of money. That is going to change that number of a little bit. But then you take a look at Education, and the numbers—the raw numbers are that they are behind a little over $4 billion, but as I understand the part that is going into the program is only 1 million at 1 billion; so that is $1,000.

Commissioner EGGER. That is correct.

Mr. ANTHONY. Then, if you go on down the list and look at Veterans, they are the smallest. You are only talking about $500 as an average loan. Here are my numbers, anyway—$5,840 for HUD; $1,000 for Education; $500 for VA; $3,100 for Small Business, and $4,317 for Agriculture.

And I think the chairman is onto a very good question, and that is, are you going to have some parity among the five representative agencies and who you are going after. If you are going to trample on VA beneficiaries for a $500 loan, and you are going to let these people slide on HUD who have a $5,800 loan, well, I can tell you I do not think that is fair.

Maybe these questions will be better asked to the people who come in.

Commissioner EGGER. Let me see if I can clarify that, Mr. Anthony. We are not going to be in a position of selecting one of the agencies——

Mr. ANTHONY. I understand what you are doing. You are just going to make the refunds and make the application back to the agency.

Commissioner EGGER. That is all.

Mr. ANTHONY. I understand that. Your average refund is about $833, right?

Commissioner EGGER. That is correct.

Mr. ANTHONY. OK. So for 1 year, if you hit the average on a VA, you are going to eliminate him.

Commissioner EGGER. Yes.

Mr. ANTHONY. The program is just for 2 years. Two years is $1,666 against $5,840.

Commissioner EGGER. Right.

Mr. ANTHONY. So I am telling you, a HUD person who has made a loan—if the program is not extended—has made a better deal in

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this program than somebody that has taken one out with the VA. That is all I am saying.

Commissioner EGGER. It could certainly work that way.

Mr. ANTHONY. So you have a pilot program that works differently for the various agencies, I do not think that is right. And if that is the way it is set up, I think it ought to be changed.

Commissioner EGGER. That is the way it is set up.

Mr. ANTHONY. Well, I think the agencies themselves ought to take this into consideration, I will ask those questions when I come to them. Mr. Thomas was right on target when he said if you have somebody who is going to be hit with a tax refund, they will be stupid not to take a look at what their next year's tax liability is and have no refund because the law says that there is no penalty so long as you pay in 80 percent. So what they are going to end up doing, instead of having a refund, the Government is going to be ending up trying to figure out how to collect the 20 percent debt from them, which creates some administrative problems for you.

Commissioner EGGER. Absolutely, absolutely. And I have said right along that where these taxpayers become debtors to the Government in the tax sense that it simply exacerbates our collection problems.

Mr. ANTHONY. Well, what bothers me—you know, we may sit up here and think the taxpayers are stupid. They are not stupid. Once they get hit once, they are going to sit down and figure out how to avoid it. For example, most people owing child support have remarried, and they have children—I spent 10 years of my life trying to collect child support from delinquent fathers, and I put some of them in prison. And I can tell you it is not easy, and that is one reason I supported the law to try to do something about it. This will happen with income taxes under this proposal.

But even in your own charts, you are saying that they have not learned much from their own lessons——

Commissioner EGGER. That is correct.

Mr. ANTHONY [continuing]. That 66 percent of them are repeaters.

Commissioner EGGER. That is correct.

Mr. ANTHONY. But you do have one very interesting set of numbers that does confuse me. On page 4 of your testimony, you do show that there are more people that are being brought into the system and that there is more money being collected. At the same time you are finding on the other side that people are becoming more sophisticated, and they are claiming more personal exemptions, and they are getting closer to what they actually owe in actual taxes. To me, that seems to be a disparity in the way the program is actually working. One says that it is still beneficial in total, aggregate dollars, and the other says that there is a future potential for the program base being eroded.

Commissioner EGGER. It is, in total aggregate dollars, but in terms of the individual cases, we are getting more cases, and fewer of these cases are actually offsettable, if you will, and when we offset them, we are offsetting smaller numbers.

Mr. ANTHONY. So, what you are seeing is an erosion of the ability for you to use the offset.

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Commissioner EGGER. I think that that is what we are seeing is a trend in that direction, and whether it will continue, and whether it will also hold true in the general, other types of debts I don't know. Keep in mind that up until now, we are dealing only with those families who are in a position to claim welfare benefits, and so necessarily, those are fairly low-income families.

Mr. ANTHONY. What about the non-AFDC?

Commissioner EGGER. We have not had that experience yet. We do not have any statistics on that yet.

Mr. ANTHONY. Have you done any offset in that area?

Commissioner EGGER. No, no. That begins, too, with next year, you see.

Mr. ANTHONY. The first offset will occur in 1986?

Commissioner EGGER. That is correct. So we do not have any data on anything except the AFDC families.

Mr. ANTHONY. I have just got two quick final questions. One, on page 4, again, you are being reimbursed.

Commissioner EGGER. Yes, sir.

Mr. ANTHONY. Do you think you are being reimbursed to cover your actual costs?

Commissioner EGGER. Absolutely.

Mr. ANTHONY. So you are not losing money?

Commissioner EGGER. We are not losing money. We include all of our costs in there.

Mr. ANTHONY. OK. Secondly, we have got this unfortunate problem with various court decisions. We wrestled with this thing under Social Security, with disability. And there, I thought we had a pretty confused situation, because they were just going to go by these various circuit decisions, which is crazy. My State happened to be caught up in one of those circuits, that meant we were treated differently than somebody else. That just does not make sense, when we are all under the same constitutional umbrella.

If I proposed legislation, how would you come in and testify—in support or against the legislation to make it the refundable earned income credit, attachable?

Commissioner EGGER. We are interested in having a uniform rule.

Mr. ANTHONY. I understand you are interested in a uniform rule. I am just saying, if I introduced legislation, and if I asked you to come and testify, and my legislation said that it is declared to be refundable, and you can attach it and refund it, I just want to know if you will testify for or against that.

Commissioner EGGER. I undoubtedly will defer to the Treasury Department in terms of the policy issue. But so far as we are concerned——

Mr. ANTHONY. In other words, you will not answer the question.

Commissioner EGGER. We think that is what the law is today, and that is the way we are proceeding.

Mr. ANTHONY. Well, you see, that is also something that is very disappointing; we hold these oversight hearings, and then we cannot get any answers.

Can you answer it in a personal way?

Commissioner EGGER. Well, in a personal way, I think that they should be offsettable, but it is not my role to make those kinds of

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policy judgments. My role is to be an administrator. And if the Congress decides that they want to apply that as a part of the offsettable refund, then I think that is fine.

Mr. ANTHONY. So as far as the administration is concerned, we should ask Mr. Baker?

Commissioner EGGER. I would say so, yes.

Mr. ANTHONY. Thank you very much.

I yield back my time, Mr. Chairman.

Chairman PICKLE. Well, Commissioner, in asking the question of which one of these agencies, or which programs have the worst violators, I think the committee ought to be careful that we are not trying to list them one, two, three, four, because Mr. Anthony makes a good point. A good analysis should be made of the type of program and the amount of money involved, and the figures do not always just appear as they are. So we are not trying to pin on the wall which one is the worst. But it is obvious from the chart that we can see the debt we would suspect would be the most difficult to collect now. We have got to be careful on that.

Commissioner EGGER. You see, the way the statute is written, if an agency that is participating simply certifies an amount to us, we offset that amount, and that is it.

Chairman PICKLE. Yes. I think I have recognized, too, that so far as you carrying out your instructions, if you get this amount submitted to you from an agency, you carry that out, and you do not try to pass judgment on whether they should go at it a different way, or handle it differently, agency by agency.

Commissioner EGGER. Yes, sir, that is correct.

Chairman PICKLE. But somebody has to make that determination, and I would think that Treasury and the IRS should be establishing a firm policy of what you would recommend to these agencies, because if we make that decision, we ought to have your input. So do not be hesitant to give us your opinion on it.

Mr. McGrath.

Mr. MCGRATH. Thank you, Mr. Chairman, and welcome, Mr. Commissioner.

I think we have a real dilemma here. Certainly, I am impressed by the additional burdens that this kind of a program would levy on your department vis-a-vis the computer problems that you already have, vis-a-vis the voluntary compliance that is already going down, and also, the reduction of withholding which could create for us some sort of a cash-flow problem. That dilemma, versus our ability to retrieve these outstanding loans which, in the test case, is $3.1 billion. Frankly, the publicity that these outstanding loans receive, or bad debts, I should say, receive, in editorials throughout the country makes it difficult for us to add money to programs which are worthy.

So I wonder why we just do not authorize the agencies involved to go out and hire private collection agencies with these super-computers. Further, if the Justice Department were armed with enough court cases to go out and track these people down and collect the money, we could avoid burdening your particular operation, which is already under a great strain.

Let me ask you this question. We know that the outstanding loans and the volume in the test cases is going to be $3.1 billion.

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How many outstanding loans are there outside of the five test areas? Do you have any idea at all?

Commissioner EGGER. I have no idea, Mr. McGrath. I am not sure anyone does. I certainly do not know. I have not seen anything other than just kind of gross estimates from time to time, that there is $20 billion or $25 billion, or something else.

Mr. MCGRATH. So this is simply a drop in the bucket. If we wanted to use the IRS to collect all the loans, wouldn't it add a tremendous burden to your current operations?

Commissioner EGGER. I think the things that we do not know are whether the people who owe these debts are the people that also have tax refunds coming in any proportion that would do much with the loans. That is what the test program is about. And I think until we get through there and get some statistical data, we really are not going to be able to answer those questions. That is why I support the test program. I think it is a sensible way to go at it.

Mr. MCGRATH. You responed to Mr. Anthony that the reimbursement you were going to be getting from the five agencies would be equal to or more than what it would cost to your agency.

Commissioner EGGER. Yes.

Mr. MCGRATH. I wonder how that cost, that reimbursement, compares to a recovery made by some private, outside collection agency.

Commissioner EGGER. My immediate personal reaction to that is that its much lower, much lower. I do not know of any commercial collection agency that would touch it for those kinds of costs.

Mr. MCGRATH. What kinds of percentages are you talking about?

Commissioner EGGER. Well, if you look at the dollars we are collecting right now, even with these relatively low-income groups, we are talking about $450 to $500 per case, and we charge $3.20.

Chairman PICKLE. Would the gentleman yield?

Mr. MCGRATH. Certainly.

Chairman PICKLE. In connection with that point, I think we are overlooking a very serious question. You are being reimbursed sufficiently for the time that you spend on this program——

Commissioner EGGER. Yes, sir. Basically, it is a fully automated program.

Chairman PICKLE. The problem, though, seems to be more far-reaching than that. In view of the manpower ceilings we have now, and manpower and computer processing limitations, you are understaffed now. One of the most difficult questions we have had this year is how do we restore for Internal Revenue the number of employees you say you need—but you would not ask for—which the Appropriations Committee has given to you.

Commissioner EGGER. It depends on where you ask for them, Mr. Chairman.

Chairman PICKLE. Well, at any rate, the Congress took the bull by the horns, and we did restore through the Appropriations Committee the amount of money that OMB would have cut and then restored a year later, and in addition, we have given you—at least the House has voted—some 1,000 to 1,500 additional employees in both enforcement and in taxpayer services.

Now, you are hard-pressed for good, qualified people, and you need more personnel. But if you use a sizable amount of your

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people for the debt collection, aren't you actually using that manpower that could be more properly utilized somewhere else? How do we balance the equities on this?

Commissioner EGGER. OK. Mr. Chairman, let me see if I can clarify that. I think the first year of this program, your point would have been right on target. However, we have been able to automate this whole program, so that we use very, very little in the way of personnel time or anything else to do it.

What happens is we simply mark, if you will, the master file, and when a refund comes through, either part or all of it goes off to a different place, like HHS, or the State agency, or whatever, instead of going back to the taxpayer. It involves almost no significant amount of additional effort on our part, the way we have it automated at this point.

Otherwise, we could not do it for $3.20.

Mr. MCGRATH. Well, that is the question. Let me follow up on that. You said that it is costing you $3.20, and you are reimbursed that $3.20.

Commissioner EGGER. That is correct.

Mr. MCGRATH. But you only are referring them back to the agency and collecting the money. I wonder how much it is costing those agencies to handle those referrals, in addition to the $3.20? That amount could make up the difference between what would be a reasonable percentage of recovery for an outside collection agency.

Commissioner EGGER. Right. I think, Mr. McGrath, that that is an appropriate line of inquiry. On the other hand, I am aware that at least some of the agencies have in fact used outside collection agencies in the past, and I am sure they can give you information on that which I am just not privy to.

Mr. MCGRATH. I will be asking that question of the individual agencies.

Thank you, Mr. Chairman.

Chairman PICKLE. Mr. Anthony, did you have another question?

Mr. ANTHONY. Yes, I have one additional question.

On page 8, you talked about an innocent spouse being brought into the network, and saying that the innocent spouse could be held harmless if they took certain actions.

Commissioner EGGER. Yes, sir.

Mr. ANTHONY. Well, it would appear to me that these certain actions obviously are going to cause some additional costs to that innocent spouse. Do you have any records that would indicate how many of these amended returns have been made and how many cases we have of the innocent spouse?

Commissioner EGGER. I do not have the precise number. My understanding is it is a relatively small number. But we would be happy to provide that information for you.

Mr. ANTHONY. I would like to have some indication of what the current status is, and if you could kind of monitor that as you go through.

Commissioner EGGER. We do, and we will provide that information.

[The information follows:]

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VOLUME OF FORMS 1040X FILED BY "INNOCENT SPOUSES" IN REFUND OFFSETS OF JOINT RETURNS

	1982	1983	1984	1985 [1]	Total
Number of offsets	278,896	339,562	423,139	476,356	1,517,953
Number of claims	8,579	7,559	10,665	5,413	32,216
Percent of claims to offsets	3.0	2.2	2.5	1.1	2.1

[1] January through September

Mr. McGRATH. Here is the place where the program could get bogged down.

Commissioner EGGER. Surely.

Mr. McGRATH. I could set you up a scenario where the innocent spouse could come to my congressional office in Eldorado and complain. I would say, "Well, you know, you are right, and you should not have been brought into this network. It was your guilty spouse who should have been taking care of the problem." And that additional cost should not be borne by an innocent taxpayer. It is an area we ought to be keenly aware of, and as we do our proper oversight, we ought to monitor to make sure there is not any abuse of that.

Commissioner EGGER. We are trying to see to it that in each instance where the taxpayer is notified that there is to be an offset, they are also notified that they may simply provide us with the information relative to whose incomes and whose deductions, and then we will——

Mr. McGRATH. And then you would help sort it out.

Commissioner EGGER. Right; yes.

Mr. McGRATH. So you can set up a procedure whereby your personnel and your experts could assist that innocent person without them going to H&R Block or to their CPA or tax lawyer.

Commissioner EGGER. That is correct.

Mr. THOMAS. Would the gentleman yield on that point?

Mr. McGRATH. Well, I would like to commend you for doing that, and strongly encourage you to work on it.

Mr. THOMAS. Would the gentleman yield?

Mr. McGRATH. Yes, I yield.

Mr. THOMAS. I was intimately involved in writing the legislation on the child support program. When this matter came up, we knew it was a problem which we had to face and address. That is, what do you do with someone who remarries, and they file a joint return, which is subsequently attached.

The committee and the subcommittee wrestled long and hard to make sure it would be a virtual, automatic procedure for persons in that category. A whole set of procedures for IRS was carefully drafted so that undividuals would not be bounced between agencies in an attempt to resolve that problem. They have worked it out very well, and that is one of the areas I want to monitor very carefully on the test project—one, to see how many, and second, to see how smooth the operation is.

Commissioner EGGER. Right. Mr. Chairman, I am informed that of the cases that we do offset, that this nonobligated spouse situation occurs in about 2 percent of the cases.

Mr. McGRATH. Two percent?

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Commissioner EGGER. Yes, sir.

Mr. MCGRATH. Could you give me some indication of the time delay and whether or not any interest accrues to moneys owed and subject to withholding as a result of missing deadlines?

Commissioner EGGER. Right. I would like to give you a full story on that, if I may, Mr. McGrath.

Mr. MCGRATH. Certainly. Thank you very much.

[The information follows:]

INTEREST ACCRUAL AND TIMEFRAME FOR PROCESSING "INNOCENT SPOUSE" REFUND OFFSET CASES

Forms 1040X filed for "innocent spouse" refunds are processed under the same timeliness guidelines as all other Forms 1040X and interest accrues from the due date or the actual received date of the original Form 1040, Individual Income Tax Return, whichever is later.

A complete and properly filed Form 1040X "innocent spouse" claim should be processed by a Service Center eight to ten weeks. However, this timeframe is extended when the claim is incomplete, requiring taxpayer contact, or when the "Agency" has made a "refund" of all or part of the offset to the joint taxpayers. To eliminate the issuance of "duplicate" refunds (a refund from both the "Agency" and the Internal Revenue Service), we have designed our computer program to enable the "Agency" to mark our files when they issue a refund. This procedure causes our "refund" transaction to be rejected by our master file, and a manual review of the case is performed to determine the correct amount of "refund" to issue.

In the past, we experienced many delays in processing claims against offsets which were made during the first two years of this program (1982 and 1983) because of the inherent problems of a manual system. To ensure that "duplicate" refunds were not issued, it was necessary to secure a verification request from the Office of Child Support Enforcement to establish whether the State Agency had issued a refund. This alone would delay our issuance of a refund by 30 to 60 days. Since automation of the "offset" process in 1984, we have experienced an improvement in the efficiency of the "innocent spouse" claim processing. Further improvements have resulted through enhancements of our system, i.e. the automation of the "verification request" on Agency refunds, and the development of a taxpayer use form to assist the "innocent spouse" in separating the income and deductions on the joint return. Our measure of this improvement is based on the reduced number of "problem" cases being brought to our attention through congressional correspondence, taxpayer correspondence to our Problem Resolution Officers, and requests for assistance from the Office of Child Support Enforcement. A direct improvement in processing these claims will result from the increased volume with the addition of other Federal Agency debt offsets. The increased volume will enable us to concentrate processing in a centralized area within our centers. With this capability, we will be able to develop and maintain the expertise necessary to provide timely accurate refunds.

Statistical data is not available to determine the precise timeframes for these claims or for any Forms 1040X we process. Our controlled inventory reports categorize the age of cases between those that are current (less than 45 days) to those that are old (more than 45 days). Due to the many problems we have experienced this year, our "aged" cases are higher than would normally be experienced. While we cannot give you exact numbers, these claims are being given priority treatment.

Chairman PICKLE. Commissioner, I understand that you will be supplying the committee with additional information, to give us a broader picture of this entire problem.

Commissioner EGGER. We certainly will, and we will include Mr. Anthony's question in that, too.

Chairman PICKLE. Fine. Now, I want to thank you. I hope that you or someone from your agency can stay with us this morning. We are going to have witnesses now from some of the agencies, and we may want to ask questions of the IRS as we go along, too.

Commissioner EGGER. We will do that, Mr. Chairman.

Chairman PICKLE. Well, we thank you very much for your testimony, and we appreciate your cooperation.

[Additional information supplied follows:]

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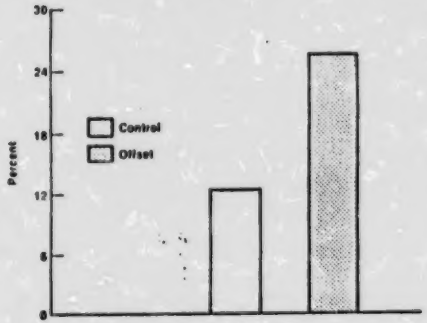
The Effect of Refund Offsets
for Delinquent Child Support
Payments

I. **Key Findings**

A. **Change in Filing Patterns:** Of the taxpayers with a tax year 1981 (TY81) refund offset, almost 26 percent did not file a tax year 1982 (TY82) return as of the end of September 1983. As shown in Chart 1, this is more than twice as many as the control group[1/] (12 percent). Since the refund offset is the only critical tax-related item that differentiates these two groups of taxpayers, the refund offset is a highly probable cause for the disproportionate number of non-filers noted.

Chart 1. TY81 Refund Cases
Without A TY82 Tax Return



Department of the Treasury
Internal Revenue Service
February, 1984

[1/] The control group is a stratified sample of refund returns without a refund offset for delinquent child support that parallels the refund offset group in terms of taxable income and filing status.

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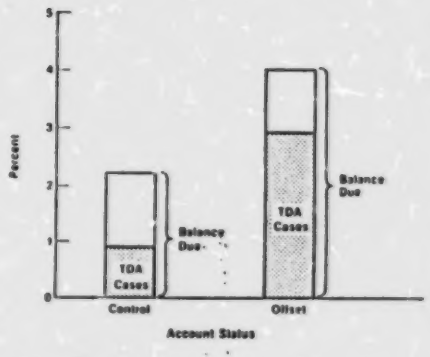
B. **Changes in Tax Payment Delinquency Rates:**
As depicted in Chart 2, refund offset cases were almost twice as prone to be balance due[1] cases in the subsequent tax year as control group cases. Refund offset cases also were three times as likely to result in a Taxpayer Delinquency Account (TDA). Balance due returns and especially TDA's represent a serious financial burden on the Service as additional field resources are expended in an effort to collect the tax liability.

Chart 2. TY81 Refund Cases That Became TY82 Balance Due and TDA Cases



[1] Balance due returns are all those where a tax liability was still outstanding after a notice was sent to the taxpayer, as of September 1983. These cases may be paid or otherwise resolved as a result of notices mailed to taxpayers. Where a series of four notices does not achieve closure, the balance due case moves to the status of Taxpayer Delinquent Account (TDA), and is referred for further collection action to personnel in IRS field offices.

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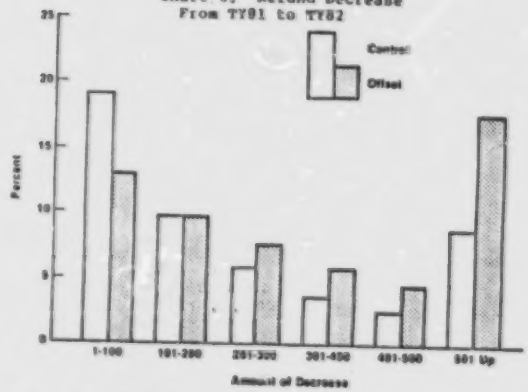
C. **Changes in Size of Refund:** A significant decrease was noted from TY81 to TY82 in the number of the refund returns available for offset. About 60 percent of the refund offset cases had a smaller refund for TY82 than for TY81 as compared to 50 percent for the control group. The size of the decrease was also more pronounced for the refunds of the taxpayers who had been offset (see Chart 3). This decline was due to a decrease in the number of dependents claimed on their returns, rather than any apparent change in withholding. Since the number of dependents claimed declined significantly, the excess withholding which normally would have resulted in refunds was absorbed by the increased tax, thus mitigating the incentive to initiate a change in withholding.

Chart 3. Refund Decrease From TY81 to TY82



D. **Changes in Withholding Patterns:** Changes in withholding patterns could not be measured with any precision due to study limitations. [See "Study Methodology and Limitations".] The ratios of withholding to salary analyzed for the year after the initial offset do not reflect a significant difference between the refund offset group and the control group. A ratio of withholding to salary was analyzed because examination of actual W-4 withholding statements at the taxpayer's place of employment was not possible for this study. It must be recognized that insufficient time (six months at best) had elapsed for a change in the withholding/salary ratio to make itself evident in the tax system. Taxpayers must have been notified of the refund offset, realized that a change to withholding could be used to circumvent offsets in subsequent years, and instituted the change in the payroll system.

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E. Changes in Number of Dependents Claimed:

Taxpayers with a refund offset reduced the number of dependents claimed on the TY 82 tax return as compared to the TY81 tax return. (See Chart 4.) Since these taxpayers had not actually provided child support payments, they could not legally claim the child as a dependent; they may have connected illegally claimed dependents with the refund offset. A reduction in the number of dependents claimed on the tax return may have reduced or completely eliminated the refund that would have otherwise been expected, without the taxpayer taking specific action to change withholding.

A comparison of the change in the number of dependents claimed by the control group (see Chart 5) shows very little difference between TY 81 and TY82.

Chart 4. Dependents Claimed by Offset Group for TY81 and TY82

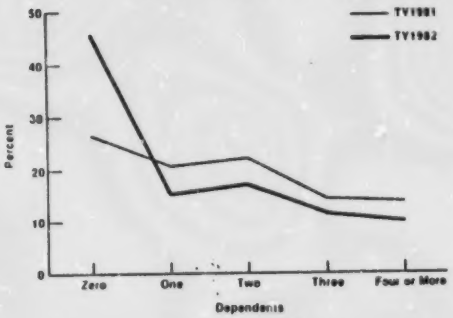
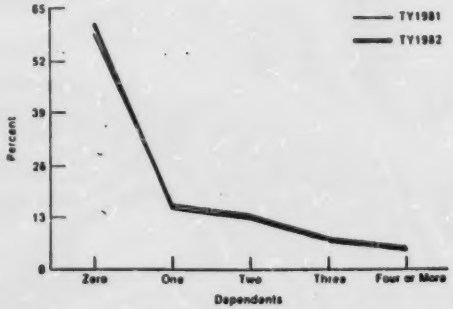


Chart 5. Dependents Claimed by Control Group for TY81 and TY82



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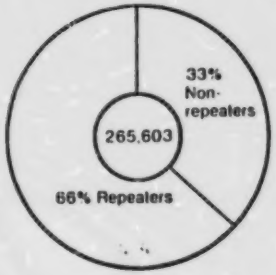
F. **Success Rate for Refund Offset:** [1]
The number of cases referred to the Service by the Office of Child Support Enforcement has increased from 547,000 in processing year 1982 to 821,000 in processing year 1983. While the percentage of referral cases that match the IRS file of individual taxpayers remained constant between the two years, the percentage of cases that resulted in an actual refund offset for delinquent child support payments declined from 51 percent in 1982 to 39 percent in 1983 (through August). The average offset amount also declined during this period from $624 to $526 per offset cases.

Chart 6. TY81 Refund Offset Cases in TY82



G. **Effect of Refund Offsets on Program Repeat Rate:**
Out of a total of 265,603 taxpayers actually subjected to refund offset in TY81, 175,526 (66 percent) were referred to the IRS by the State agencies again for TY82. (See Chart 6.)

[1] These data are approximations based on information manually compiled from operational data processed on a calendar year basis, irrespective of the tax year. Processing year 1982 would generally, but not exclusively, include tax year 1981 returns and processing year 1983 would generally include tax year 1982 returns.

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II. Study Methodology and Limitations

A. Study Methodology:

The Internal Revenue Service received a mandate in Public Law 97-35, the Omnibus Reconciliation Act of 1981, to offset individual income tax return refunds to collect delinquent child support from taxpayers referred by the State through the Office of Child Support Enforcement of Health and Human Services (HHS). Participation by the States in this program is also mandatory under the Act. All of the TY81 referral cases (465,535) that matched the IRS file of individual taxpayers were selected as the study group for this analysis. The study group was then divided into two groups, those with an offset for delinquent child support payments (265,603) and those with no offset (199,932), which were both tracked from TY81 to TY82 to compare filing and withholding patterns. The primary focus of this analysis was on the refund offset group to determine the changes in filing and withholding patterns that may have been stimulated by the offset, as compared with a control group. The control group, a stratified sample of 153,429 refund returns having no refund offset for delinquent child support, paralleled the refund offset group in terms of taxable income and filing status.

B. Study Limitations:

Changes in withholding patterns were unable to be measured with precision. The most accurate approach to determine if there had been a change in withholding would be an examination and comparison of Forms W-4 filed by the taxpayer with the employer. This would have involved contacting employers to obtain the information. Since no tax liability issue was involved, this option was not exercised. Therefore, the analysis of withholding patterns was restricted to a ratio of withholding to salary, i.e., data available on IRS files.

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Selection of a control group represents another limitation. The ideal control group would have been a sample of delinquent child support cases where a refund available for offsetting would purposely not have been offset. This would have assured that any significant differences between the control group and the offset group could have been completely attributed to the refund offset. This, of course, would have violated the concept of equitable enforcement of the referrals offset provisions of Public Law 97-35.

Instead, a stratified sample of refund cases without a refund offset for delinquent child support was selected to parallel the refund offset cases in terms of taxable income and filing status. However, there are numerous other factors such as number of dependents claimed, size of refund, deductions, and credits that were not able to be incorporated into the selection criteria of the control group because of lack of available stratified data. In addition, it would be impossible to select a control group that would reflect the social characteristic of the group under study, i.e., their refusal to pay legally mandated support which forced their families onto public assistance.

Because of these limitations, caution must be used when projecting the findings of this analysis into other areas of non-tax debt collection through the refund offset method.

III. Future Action

While the actual effect on withholding behavior may not yet accurately be determined, given the inherent limitations of the study data, the increase in non-filing is noteworthy. The Service will continue to follow TY81 refund offset cases in a third year (TY83) to measure the long-term effects of the refund offset program on the tax system.

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COMMISSIONER OF INTERNAL REVENUE

Washington, DC 20224

OCT 08 1985

Dear Member of Congress:

Starting in January of 1986, the Internal Revenue Service will be involved in two separate experimental programs involving the collection of overdue non-tax federal debts through the offset of federal income tax refunds. This letter and the enclosed Fact Sheets are designed to alert you to the upcoming tests and to provide you with information on them that you can share with your constituents.

One program starting in January 1986 involves child and spousal support enforcement. The IRS has been offsetting income tax refunds for individuals under the Aid to Families with Dependent Children (AFDC) program since January, 1982, as authorized by the Omnibus Budget Reconciliation Act of 1981 (P.L. 97-35). Now, as authorized by section 21 of the Child Support Enforcement Amendments of 1984 (P.L. 98-378), this offset effort will be extended to non-AFDC situations on a five-year test basis, beginning with refunds issued after December 31, 1985. Operationally, these programs will be similar. Any constituent inquiries you receive on these programs should be referred to the Department of Health and Human Service (HHS), since that agency certified the debt to IRS and we have no independent method of verifying constituent claims.

The second program starting in January involves a two-year test of collecting non-tax federal debts through the offset of income tax refunds for selected federal agencies, as authorized in section 2653 of the Deficit Reduction Act of 1984 (P.L. 98-369). This test is intended to determine whether such a refund offset program has adverse tax administration effects. The Service has selected five agencies (the Small Business Administration, the Veterans Administration, and the Departments of Education, Agriculture, and Housing and Urban Development) to participate in the test, subject to final criteria being established.

Under this program, when a participating federal agency advises IRS that a taxpayer owes a past due debt, the IRS will offset any refund due to satisfy the amount of the debt. (If the taxpayer's refund exceeds the amount owed, the balance will be refunded.) Before any income tax refund is withheld, the creditor agency will notify the debtor-taxpayer of the fact that a referral to the Internal Revenue Service is contemplated. The debtor will then be given an opportunity to challenge the validity or amount of the debt. It is the creditor agency, and not the IRS, that will determine whether the debt is overdue and legally enforceable; the IRS will act only as a collection agent for the creditor agency. In the event an offset is made, the debtor will receive a notice from the IRS explaining the offset. That notice will contain information telling the debtor how and where to contact the federal agency involved.

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Both of these tests can be complicated by the filing of a joint return. In some instances, the refund that is offset does not belong to the debtor-taxpayer, but to the debtor-taxpayer's spouse, who may not be liable for the debt. The notice sent to the taxpayer will contain information on how the taxpayer may resolve disputes involving an offset of a refund for a joint tax return.

This refund offset test also may lead to constituent inquiries to your office. Inquiries on the amount or the validity of the debt must be referred to the creditor agency to which the debt is owed, since the IRS has no method of verifying such claims. Inquiries regarding the appropriateness of an offset on a joint tax return may be referred to the IRS as indicated on the IRS notice.

You are encouraged to use the enclosed Fact Sheets to advise your constituents of these two tests.

With kind regards,

Sincerely,

Tom E. Persky
Assistant to the Commissioner
(Legislative Liaison)

Enclosures

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Department of the Treasury
Internal Revenue Service
Legislative Affairs Division

LEGISLATIVE FACT SHEET

Date OCT 08 1985 Number 85-2

Tax Refund Offset for Child and Spousal Support Extended to Non-AFDC Situations

As a result of legislation enacted last year, the Internal Revenue Service will begin offsetting income tax refunds to collect overdue child and spousal support funds in non-AFDC (Aid to Families with Dependent Children) situations, effective January 1, 1986. A five-year test of this program was authorized by section 21 of the Child Support Enforcement Amendments of 1984 (P.L. 98-378).

The IRS had been offsetting income tax refunds to collect overdue support funds in AFDC situations since January, 1982, as authorized by the Omnibus Budget Reconciliation Act of 1981 (P.L. 97-35). The 1984 law merely extends the same program to non-AFDC situations for five years.

Both the AFDC and non-AFDC programs are expected to operate in a similar manner. Basically, data on the individuals involved, the existence of their obligations, and the amounts to be offset are validated by the states and sent to the Office of Child Support Enforcement (OCSE) at the Department of Health and Human Services (HHS). HHS then forwards this information to the Internal Revenue Service, where it is used to identify those taxpayer accounts to be offset if and when refunds become due.

In both AFDC and non-AFDC situations, the amounts offset represent child and spousal support obligations. However, in AFDC cases the funds collected through offset are paid to the states, to reimburse them for AFDC payments already made to the child or spouse of the debtor-taxpayer. (As a condition of receiving AFDC assistance, individuals must assign their rights to the support payments to the state involved.) In non-AFDC cases, the funds collected through offset will be paid to the individual owed the support payments, not a governmental entity.

Constituent inquiries regarding the refund offset must be referred to the Department of Health and Human Services (HHS), since that agency certified the debt for overdue support to IRS, and IRS has no independent method of verifying constituent claims. Claims that the refund belonged in whole or in part to the debtor's spouse may be referred to the IRS as indicated on the notice of offset to be sent to the debtor by IRS.

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Department of the Treasury
Internal Revenue Service
Legislative Affairs Division

LEGISLATIVE FACT SHEET

Date: OCT 08 1985 Number 85-3

Tax Refund Offset for Non-Tax Debts

As a result of legislation enacted last year, the Internal Revenue Service will begin collecting non-tax federal debts through the offset of income tax refunds effective January 1, 1986. A two-year test will be conducted as authorized by section 2653 of the Deficit Reduction Act of 1984 (P.L. 98-369), in order to determine whether such an offset program has adverse tax administration effects.

A tax refund will not be withheld by the IRS for a non-tax federal debt until the federal agency that is owed the debt has taken the following steps. First, the agency must notify the debtor that it is proposing to refer the debt to the IRS to offset against any tax refund that may become payable. Second, the debtor must be given sixty days to present evidence that the debt is not past-due or is not legally enforceable, and the agency must consider any evidence submitted in evaluating the validity of the debt. If these steps have been followed and the agency still determines that the debt is valid and the debtor still refuses to pay, any subsequent tax refund due the debtor will be withheld to the extent necessary to offset the debt to the federal agency.

In the offset process, the IRS' only role is to act as a collection agent for the federal agency to which the debt is owed. The IRS makes no determination as to whether the debt is overdue or legally enforceable. The IRS is merely administering the offsets for the federal agencies and has no means of verifying the information supplied by the federal agencies.

The IRS anticipates that five federal agencies will participate in the first year of the refund offset test. One of these agencies will be the Department of Education, to which over $1 billion is owed by more than 1 million people who have defaulted on direct student loans or federally insured student loans. The Small Business Administration, the Veterans Administration, and the Departments of Agriculture and Housing and Urban Development will also participate in the test, subject to final criteria being established.

Constituent inquiries regarding the refund offset must be referred to the agency to which the debt is owed. Because the IRS is not involved in the establishment of the basic debt or the decision to use IRS to offset a particular refund, it is not equipped to handle inquiries on those portions of the process. Claims that the refund belonged in whole or in part to the debtor's spouse may be referred to the IRS as indicated on the notice of offset to be sent to the debtor by IRS.

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Chairman PICKLE. Now the Chair is going to call a panel, consisting of the five agencies that have been mentioned. Let me ask that you come and take your seats, starting at my left.

First, Judith Tardy, Assistant Secretary of the HUD agency; next, Mr. Richard Hastings, Director of the Debt Collection and Management Service of the Department of Education; next, representing the Veterans Administration will be Jerry McRae, Director of the Debt Management Staff; next will be the Small Business Administration testifier, Mr. Edwin T. Holloway, and last, the Department of Agriculture representative, Mr. David Neverman, Acting Deputy Administrator for Financial and Administrative Operations of the Farmers Home Administration.

We are going to ask each of you to submit your statements, and if you can summarize, it would be appreciated.

We will start with you, Ms. Tardy.

I think if the committee is agreeable, we will ask each one of you to make your statements, and then we will come back and ask questions, in the interest of time. I do not know whether that is a vote coming up, or what, but we will see.

Mr. MCGRATH. They just went into session.

Chairman PICKLE. Then, we will proceed.

First, we will hear from Judith Tardy, Assistant Secretary, Department of Housing and Urban Development.

Ms. Tardy.

STATEMENT OF JUDITH L. TARDY, ASSISTANT SECRETARY FOR ADMINISTRATION, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Ms. TARDY. Good morning, Mr. Chairman.

I am pleased to be here today to discuss with you HUD's debt collection efforts under title I of the National Housing Act and, in particular, our preparations for the IRS Income Tax Refund Offset Program.

HUD has been selected as one of five Federal agencies to participate in the administration's plan to use Federal income tax refunds to help collect debts owed to the Government. HUD will use this program only in cases where all other routine collection efforts have failed.

As background, let me briefly describe the Title I Insurance Program. It ensures participating lenders against loss on eligible loans if the borrower defaults. These loans are privately-funded, consumer loans which are made to finance improvements of homes, commercial or agricultural buildings or to purchase a manufactured home. As HUD pays a lender's claim, any deficiency balance is assigned to the Department for collection. Currently, HUD holds about 62,000 of these defaulted notes which represent $212 million in principal and $58 million in accrued interest.

Within 10 days after a claim is paid, a demand letter is automatically issued to new debtors encouraging them to establish a repayment plan. Generally, the Department expects the debtor to abide by terms similar to those contained in the original note, but compromises and longer terms are negotiated based on the financial circumstances of the debtor.

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If the first demand letter goes unanswered, it is automatically followed by three progressively stronger notices. Debtors who fail to establish a repayment plan during this first collection phase are then contacted by telegram or telephone in an effort to effect a repayment plan.

Currently, about 44 percent of all debtors are on repayment plans. Almost 38 percent are not paying and have not made a payment in over 1 year. An additional 18 percent have very poor paying habits and are 90 days to a year delinquent. These last two categories of debtors are expected to comprise the universe of our referrals to the IRS.

Mr. McGRATH. Would you repeat that last statement.

Ms. TARDY. The percentages?

Mr. McGRATH. About what would comprise the universe.

Ms. TARDY. The universe of accounts from which we will take referrals is the 38 percent who are not paying and who have not made a payment in over 1 year plus the 18 percent who have not made a payment between 90 days and 1 year.

After all other collection efforts are exhausted, HUD expects about 25,000 debtors with a total of $126 million owed to be referred to the IRS. Each of these accounts, despite HUD's efforts, will either have paid nothing to retire the debt or will be seriously delinquent.

By the end of this month, HUD will publish final rules establishing, among other procedures, the handling of disputes. Our initial notice to debtors will advise them that they may request an administrative review of referral to IRS within 25 days. They have 40 additional days to give evidence that the debt is not past due or legally enforcable. If the debtor disputes the proposed offset and requests a review, HUD's Board of Contract Appeals will hear the dispute and give a ruling. Similar procedures will be used in the event that the actual amount offset by the IRS is contested.

In closing, the Title I Program has been in existence for over 50 years. It is an important part of HUD's effort to make housing affordable and decent. And in order to maintain the support it has had, we at HUD are committed to operating title I as effectively and efficiently as possible.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF JUDITH L. TARDY, ASSISTANT SECRETARY FOR ADMINISTRATION, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Good Morning. I'm pleased to be here today to discuss with you HUD's debt collection efforts under Title I of the National Housing Act and, in particular, our preparations for the IRS Income Tax Refund Offset Program for tax year 1985.

HUD has been selected as one of five Federal agencies to participate in the Administration's plan to use Federal income tax refunds to help collect debts owed to the Government. HUD will use this program only in cases where all other, routine collection efforts have failed. We will not use it in situations where the debtor is bankrupt; where the case has been referred to the Department of Justice seeking a judgment; or where the debt is less than 90 days in arrears under an agreed-to repayment plan. This Fall, Title I debtors not meeting these criteria will be notified in writing that HUD intends to refer their accounts to the IRS for collection by an offset against any income tax refund. The notice will also advise debtors that they will be allowed 60 days to cure the outstanding delinquency. Accounts that are not brought current will be transferred by tape to the IRS in December.

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As background, let me briefly describe how the Title I Insurance Program operates. It insures participating lenders against loss on eligible loans if the borrower defaults. These loans are privately-funded, consumer loans which are made to finance improvements of homes, commercial or agricultural buildings or to purchase a manufactured home. Approximately $100 million in new loans is insured monthly by the Department. Currently, over $6 billion covering some 1.2 million loans is contained in HUD's insurance-in-force portfolio.

In 1985, HUD will pay approximately 16,000 claims under Title I totaling $84 million. As HUD pays a lender's claim, any deficiency balance is assigned to the Department for collection. Interest continues to accrue on these defaulted notes until they are paid in full. Currently, HUD holds about 62,000 of these defaulted notes which represent $212 million in principal and $58 million in accrued interest. The average property improvement deficiency is $3,500 and the average manufactured home deficiency is $6,500.

HUD's Title I accounting records are held centrally and are fully automated. Collection actions, however, are decentralized to 60 Field Offices. Within 10 days after a claim is paid, a demand letter is automatically issued to new debtors encouraging them to establish a repayment plan. Generally, the Department expects the debtor to abide by terms similar to those contained in the original note, but compromises and longer terms are negotiated based on the financial circumstances of the debtor. These renegotiated payments average slightly less than $80 per month.

If the first demand letter goes unanswered, it is automatically followed by three progressively stronger notices which advise the debtor the means by which the Government can collect. Debtors who fail to establish a repayment plan during this first collection phase are then contacted by telegram or telephone in an effort to effect a repayment plan.

If a debtor fails to respond to our attempts to establish a voluntary repayment schedule, HUD initiates steps to recover the debt through other means. Approximately 5 percent of our 62,000 cases have been referred to local U.S. Attorneys seeking judgments which, once obtained, serve as the basis for garnishment of salaries or attachment of assets. Also, HUD has successfully begun a salary and benefit offset program involving present and former Federal employees who are recalcitrant Title I debtors. This year, HUD has begun foreclosure proceedings against certain property improvement debts where the Department is in a first lien position. Finally, we are about to begin a small claims court pilot project through which we hope to secure judgments without formal referral to the Department of Justice.

All workout agreements with debtors are entered into the central accounting system and bills are generated monthly reminding them of the amount due and the remaining balance. Our experience has shown, however, that in any given month approximately 40 percent of our billed accounts under voluntary work-outs will not pay or will pay late. To curb this trend, HUD has recently implemented a centralized telephone call servicing program which is compatible with our accounting system and which automatically follows-up on missed payments within 10 days. We believe this system will measurably improve payment histories. However, many accounts remain chronically delinquent.

Currently, about 44 percent of all debtors are on repayment plans. Almost 38 percent (23,000 accounts) are not paying and have not made a payment in over a year. An additional 18 percent (11,000 accounts) have very poor paying habits and are 90 days to a year delinquent. These last two categories of debtors are expected to comprise the universe of our referrals. After all other collection efforts are exhausted, HUD expects about 25,000 debtors with a total of $126 million owed to be referred to the IRS. Each of these accounts, despite HUD's efforts, will either have paid nothing to retire their debt or will be seriously delinquent. Once a match is made with a particular income tax return where a refund is due, any funds up to the amount of the deficiency will be diverted from the taxpayer to HUD. IRS will return to HUD a tape of these offsets which will automatically update our accounting system.

By the end of this month, HUD will publish final rules establishing, among other procedures, the handling of disputes. Our initial notice to debtors will advise them that they may request an administrative review of referral to IRS within 25 days. Then they have 40 additional days in which to provide evidence which they believe demonstrates that the debt is not past due or that it is legally unenforceable. All offset debtors requests that the offset be reviewed will be heard by the Department's Board of Contract Appeals, an in-house three judge panel which rules on disputes between HUD and individuals or private firms. Similar procedures will be used in the event that the actual amount offset by the IRS is contested.

In closing, the Title I Program has been in existence for over 50 years. It has enjoyed wide acceptance and support. It is an important part of HUD's effort to made

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housing affordable and decent. In order to maintain the support it has had, we at HUD are committed to operating Title I as effectively and efficiently as possible.

Chairman PICKLE. Thank you, Ms. Tardy. I am sure we will have questions for you, but we will go ahead.

The next person to testify will be Mr. Richard Hastings, representing the Department of Education.

Mr. Hastings.

STATEMENT OF RICHARD HASTINGS, DIRECTOR, OFFICE OF DEBT COLLECTION AND MANAGEMENT ASSISTANCE SERVICES, DEPARTMENT OF EDUCATION

Mr. HASTINGS. Good morning, Mr. Chairman. I will summarize my testimony. I would like to hit a few highlights, especially given some of the questions that have been asked in the last few moments.

We are very enthusiastic about the availability of the Internal Revenue Service as a last vehicle in our collection efforts.

Over the last few years, we have been among the leaders in the Government with respect to the implementation of the various debt collection tools which the Congress has either given us individually as a department or which have been incorporated into the Debt Collection Act of 1982. Among those have been full implementation of the authority which enables us to report debtors to National Consumer Credit Bureaus, an effort which is working very well. We currently are getting from 75 to 100 calls a week in our regional offices from people whom we have reported to credit agencies.

A coordinated effort has been made between us and the Department of Justice in the last 6 months in which we have attempted to go out and litigate those who were not able to be otherwise convinced that they ought to honor their just and legal obligations. We have sent about 16,000 names to U.S. attorney's offices around the country between December 1984 and the end of August, averaging about $3,000 per case.

Obviously, there has been some discussion in the last couple of years within the Congress about whether or not additional authority is necessary, and there is an Oversight hearing next week on the possible use of private attorneys to assist the Justice Department where there are additional efforts needed.

Use of private sector collection agency contracts is being expanded even further through follow-up contracts which were awarded on September 17. We have been using private collection agencies since 1979. We had, I believe, the first authority in the Government to use those agencies. We did a pilot for 2 years that appeared to work very well. We then extended that effort significantly. We were able to reduce Federal staff by 700 individuals in fiscal year 1981 as a result of a mixture of Federal employees and private collection agencies. Every account which we are referring to the Internal Revenue Service has been sent first to a collection agency, and we are paying collection agency's rates up to 40 percent.

Major improvements in our debt collection system software has enabled us to more effectively utilize the authorities provided by the Debt Collection Act of 1982.

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And we have fully implemented procedures to identify, locate, and offset the salary of Federal employees who have failed to repay their student loans.

The improvements that we have made in the last few years have resulted in an increase in amounts collected from about $46 million in fiscal year 1981 to slightly over $91 million in fiscal year 1984. And overall we have collected $480 million on these loans. Secretary Bennett announced in a press release last week, this year alone, this fiscal year, taxpayers of this country are going to pay $1 billion in additional defaulted Guaranteed Student Loans. Based on the volume in that program, we anticipate that that number is going to continue for the foreseeable future, approaching a billion-and-a-half by the end of the decade. Less than half, as I recall the numbers, of all Guaranteed Student Loans that have ever been made have yet to come into the repayment phase. We need to not only collect the debt that is already in default, we also have to provide sufficient warning to people who are thinking about it, that something bad is going to happen if they do it.

Even in light of our accomplishments, however, we believe that much remains to be done. I would like to address now the specific questions that were asked in the letter of invitation. First of all, let me say that all of our numbers, at least as far as the Department of Education is concerned, are obviously estimates at this point. We have actually sent 60-day notices to about one-half million people as of last weekend. There will be another quarter of a million going out this weekend. That will be three-quarters of a million that we will send out on the Federally Insured Student Loan and National Direct Student Loan portfolios, for which we have direct collection responsibility.

In addition, we have been working with the State guarantee agencies who guarantee the Guaranteed Student Loans. We are subrogated to the rights of the agencies in the paper, and we are going to ask the agencies to assign a portion of that paper to us so that it will then become eligible under the IRS offset process, and we will be sending those amounts as well.

We are estimating at this point perhaps another million accounts in the GSL Program may be referred, but obviously it depends on how many agencies participate, for one thing. We expect that the agreements with the agencies will be signed next week.

With respect to the specific procedures for implementing the offset program, we, as I say, have begun to mail our 60-day notices. We are already getting some interesting results. I spent two days in our Chicago regional office a couple of weeks ago and a day in our San Francisco regional office just sitting behind collectors while they were talking to individuals. Our computer system has a flag built in so that when they call the debtor's account up on the screen, we can tell whether or not they have received the IRS notice at that point. Virtually every phone call coming in was from someone who had either received the IRS notice or who knew about it as a result of the publicity that we generated before we sent out the first letter.

Also interesting, perhaps for Commissioner Egger, were the number of people who began the conversation by saying, "I want to

take care of this because I do not want the IRS to find out about it."

I do not know what that means, but the average payment for people who have gratuitously simply torn off the top third of the letter which we made into a billing statement and sent it in to us is $320 per payment, which is about four times our average payment for people who are on the regular billing system. We have received several checks for $4,000 and many more between one and four thousand dollars. Obviously, we are very early into the heel on that curve. As we move closer and closer to December and people begin to think about those returns they are going to be filing in January, we expect we are going to have a very large number of people voluntarily paying in full, or at least contacting us and making repayment arrangements.

The notice is similar to others that will be addressed here this morning, in that we do notify the debtor of his rights and offer him the opportunity to present any information to us concerning the question of whether or not the debt is legally enforceable.

We also are doing that with accounts that are currently at our collection agencies, except that we are putting their names and telephone numbers on those accounts and they will be doing the same thing.

We estimate our production costs to be about $800,000 in the first year of this program. We have provided for extensive accounts receivable tracking of this process because both we as well as OMB and the Internal Revenue Service are very interested to know exactly how effective this tool has been. This process essentially is entirely automated except for the people who are actually talking to debtors on the telephones, obviously, and answering mail.

We believe and we think that the IRS offset is going to be the most effective tool we have had available to us. We are estimating recoveries of $250 million in the first year of the program, and we are extremely enthusiastic about our participation.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF RICHARD HASTINGS, DIRECTOR, OFFICE OF DEBT COLLECTION AND MANAGEMENT ASSISTANCE SERVICES, U.S. DEPARTMENT OF EDUCATION

Mr. Chairman and members of the subcommittee, we very much appreciate this opportunity to discuss with you the joint effort by the Department and the Internal Revenue Service to use tax refund offsets to collect nontax Federal debts. In our opinion, this collection tool will prove to be the most effective of all our efforts to recover hundreds of millions of dollars from individuals who have failed to meet their responsibilities in repaying monies owed to the Federal Government under the Guaranteed Student Loan and National Direct Student Loan Programs. However, before addressing the issues outlined in your letter of invitation concerning the tax refund offset program, I would like to review briefly the Department's recent accomplishments in the area of student loan collections.

We are proud of the progress we have made in improving our record of success in collecting on defaulted student loans. In the past 2 years we have implemented a number of major initiatives which have enhanced our performance. Among these have been:

Full implementation of the authority which enables us to report debtors to national consumer credit bureaus in order to adversely affect their ability to obtain credit financing. Our offices are now reporting an average of 75 to 100 calls a week from affected borrowers as a result of this measure—a strong testament to its effectiveness.

A coordinated effort teaming the Departments of Justice and Education in pursuing litigation on default cases. More than 16,000 cases have already been sent to Justice. Cases will continue to be referred at the rate of approximately 300 per month.

Full implementation of private sector collection agency contracts which are being expanded even further through followup contracts which were awarded on September 17.

Major improvements in our debt collection system software which have enabled us to more effectively utilize the authorities provided by the Debt Collection Act of 1982; and

Full implementation of procedures to identify, locate and offset the salary of Federal employees who have failed to repay their student loans.

These improvements have contributed to an increase in recoveries from a level of $46 million in fiscal year 1981 to $91 million in fiscal year 1984. Overall, the Department's student loan collection effort has recovered approximately $480 million. Since 1981, we have recovered $342 million at a cost of $83.6 million.

Our 1984 all-time-high collection figure ($91 million) has been a direct result of the increased priority that the Department has given to debt collection management. We have recently established the Debt Collection and Management Assistance Service Office within the Office of Postsecondary Education which reports directly to the Assistant Secretary for Postsecondary Education. This organization focuses its full attention on debt collection.

Even in light of these accomplishments, we believe that more should be done. For instance, the Department recently publicized a sharp and alarming increase in the default rate for the Guaranteed Student Loan program. This program is the larger of the two student loan programs currently administered by the Department. We now anticipate that about $1 billion in default claims will be paid by the Department in 1985—the highest annual amount since inception of the program. If the current trend is not checked, default costs in the Guaranteed Student Loan Program could exceed $1.8 billion by 1990 with the cumulative total of Guaranteed Student Loan defaults reaching almost $12 billion in just 5 years.

I would now like to address the specific questions regarding the use of tax refund offsets by the Internal Revenue Service to collect nontax Federal debts which you raised in your letter of invitation.

The Department anticipates forwarding to the Internal Revenue Service approximately 1,500,000 accounts valued at approximately $3 billion. These debts represent defaulted student loans made under the two loan programs administered by the Department—the National Direct Student Loan and the Guaranteed Student Loan Programs. With respect to the Guaranteed Student Loan Program, we are assuming participation by a majority of the guarantee agencies currently holding these accounts. The average loan debt is $2,000. These accounts have been in default for a period of anywhere from 6 months to 9 years.

With respect to the specific procedures for implementing the tax refund offset program, a notice of the pending offset will be forwarded to the best available address of each debtor at least 60 days before the Department requests the IRS in January to effect the offset. The Internal Revenue Service will send the debtor a second notice. This notice will advise the debtor of the actions the IRS will be taking, and will explain the debtor's right to dispute the existence or delinquency status of the debt, and to a review of any evidence he or she submits on these issues. The Department of Education will not seek offsets against refunds of debtors who make satisfactory repayment arrangements on their debts, or who prove that the debt is not delinquent or not enforceable.

We estimate that production costs to implement the tax refund offset program will total approximately $800,000 in the first year with future year costs yet to be determined. We have provided for extensive accounts receivable tracking of this process so that we can better monitor this activity. All interface between the Department and the Internal Revenue Service will be fully computerized thereby eliminating costly labor intensive tasks wherever possible.

As stated earlier, we fully expect the tax refund offset program to prove to be the most effective collection tool available. Evidence of our enthusiasm for this program is reflected in our estimate of expected recoveries of $250 million in the first year, assuming the majority of guarantee agencies holding accounts participate in the program. This estimate is based on an analysis of our default portfolio conducted by the IRS in 1984 which showed that 82 percent of the debtors in our portfolio received income tax refunds for tax year 1983.

In light of the kinds of questions which arise in the collection of claims on student loans, which are evidenced by signed promissory notes, the safeguards we have

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adopted to address possible disputes which may arise from the tax refund offset are numerous, beginning with our own 60-day notices which provide contact phone numbers and an explanation of the process for disputed claims. This would be followed by the IRS notice informing the debtor that the offset has been made, and subsequent contacts with both this Department's collection personnel and the guarantee agencies which insured the loans. In any case, upon request by the debtor we will review our claim in light of the arguments or evidence submitted, and where that review persuades us that the debt is not past due or not legally enforceable, we will either cancel the proposed offset or reimburse the debtor in the amount offset as soon as possible.

Mr. Chairman, I hope this testimony has been responsive to the concerns of your subcommittee. I will be pleased to respond to any questions the subcommittee may have.

Chairman PICKLE. Thank you, Mr. Hastings.

We will now hear from Jerry McRae, Director of the Veterans' Administration.

Mr. McRae.

STATEMENT OF JERRY G. McRAE, DIRECTOR, DEBT MANAGEMENT STAFF, VETERANS' ADMINISTRATION

Mr. MCRAE. Thank you, Mr. Chairman and members of the subcommittee.

We are pleased to appear this morning to provide you with our views on the use of tax refund offset by the Internal Revenue Service to collect delinquent debts owed to the Veterans' Administration. We appreciate the authority that we have been given for utilizing tax refund offsets as a very valuable aid to our efforts to collect long overdue debts where normal collection efforts have been exhausted.

We also intend to use this authority in a reasonable way and to provide reasonable restraint as we proceed in a manner which is consistent with our VA mission and sound management practices.

At this time I will address our plan for the tax refund program rather than going through the procedures leading up to it. We are in the process of implementing a 2-year plan to utilize tax refund offsets as an integral part of our debt collection program. When current systems programming for this project is complete, we will begin phase 1 of the referral process by generating a 60-day notice to those debtors whose cases have been reduced to judgment through actions by VA district counsels or the U.S. attorney's office.

These accounts, which number approximately 50,000, are valued at $48 million. Since these debts have gone through the entire VA collection process, been litigated and reduced to judgment, we anticipate few, if any, disputes when tax refund offsets occur.

The experience that we gain from handling these cases will then be used to refine management control procedures and prepare all remaining debtor cases for a second phase of referrals in 1986.

Please note here that this second phase of our tax refund offset plan begins in early 1986, and it will involve 650,000 accounts valued at approximately $600 million. These are delinquent debts being developed for referral to the IRS for the 1987 tax season. This approach accomplishes two important objectives in our overall plan. First, it affords us an opportunity to gain experience with a new program by referring cases which are least likely to result in disputes. Second, we will avoid an overload of VA collection re-

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sources by systematically notifying the remaining 650,000 debtors early enough in 1986 that we can fully resolve disputes.

We cannot tell you at this time what the results will be, but we are optimistic that this will be a significant gain for the Veterans' Administration.

Mr. Chairman, that completes my prepared testimony. I will be glad to answer questions at the end.

[The prepared statement follows:]

STATEMENT OF JERRY G. MCRAE, DEPARTMENT OF VETERANS BENEFITS, VETERANS' ADMINISTRATION

Mr. Chairman and members of the subcommittee, we are pleased to appear this morning to provide you with our views on the use of tax refund offset by the Internal Revenue Service to collect delinquent debts owed to the Veterans Administration. In accordance with your request, we will also provide a brief explanation of our collection procedures and the nature of the debts to be referred for offset.

As you know, Mr. Chairman, the President, the Administrator of Veterans Affairs, your subcommittee, Congress in general, and many others in and out of Government are seriously concerned with the collection of debts owed to the Federal Government. Out of this concern, we appreciate the authority for utilizing tax refund offsets as a very valuable aid to our efforts to collect long overdue debts where normal collection efforts have been exhausted. We also intend to exercise reasonable restraint and proceed in a manner which is consistent with our VA mission and sound management practices. I would now like to address the questions expressed in your September 12, 1985 letter to the Administrator which outlined the issues relevant to this hearing.

(1) What is the nature of the agency's outstanding debts which you have or plan to forward to the IRS, including the type of debts, the number of debts, the total dollar amount of such debts, the dollar range of individual debts, and the length of time such debts have been outstanding?

The VA intends to refer accounts to IRS for tax refund offset purposes where we have obtained judgments through litigation by the Department of Justice or by the VA's district counsels. The majority of the referrals will be education benefit overpayments. Some compensation and pension benefit overpayments and overpayments caused by default under the VA's loan guaranty program and reduced to judgment may be referred. We intend to refer approximately 50,000 accounts valued at $48 million. Information is not available to identify a specific dollar range for the referrals. However, every judgment case over $25 will be referred. The length of time the accounts have been outstanding ranges from 1 to 9 years.

(2) What existing procedures are followed in collecting debt owed to the agency, how effective are these procedures, and what costs are associated with these current collection efforts?

If an overpayment is established and the debtor is drawing moneys under another VA benefit program, he or she is informed that action will be taken to begin withholding his/her benefits to liquidate the indebtedness. If the debtor is not drawing another type of VA benefit, the account is transferred to the VA's Centralized Accounts Receivable System (CARS) where a series of collection letters are generated at 30-day intervals. If the collection letters do not result in payment in full, or the establishment of an acceptable payment plan, the account may be referred to either the VA's district counsel or to the Department of Justice for litigation. We also plan to begin referring delinquent accounts to credit reporting agencies in November of this year, which we feel will aid our collection efforts. The VA centralized and automated its debt collection program 10 years ago. In 1984, this system enabled the VA to collect $91 million in cash and realize a return of $5.83 for every $1 spent on debt collection. The majority of the costs associated with our debt collection effort are incurred with the maintenance of our Centralized Accounts Receivable System (CARS). We are currently doing an assessment of the agency's entire debt management system and developing additional procedures for further improving debt collection results.

(3) What steps will the agency have to take in order to implement this tax refund offset program, what additional costs will be incurred, and what benefits are anticipated?

We are in the process of implementing a 2-year plan to utilize tax refund offsets as an integral part of our debt collection program. When current systems program-

ming for this project is complete, we will begin phase I of the referral process by generating a 60-day notice to the applicable debtors noted above and advising them of our intent to refer their debt to the IRS for the upcoming tax season. Since these debts have gone through the entire VA collection process, been litigated and reduced to judgment, we anticipate few if any disputes when tax refund offsets occur. The experience we gain from handling these cases will then be used to refine management control procedures and prepare all remaining delinquent debtor cases for a second phase of referrals in 1986. Please note here that this second phase of our tax refund plan begins in early 1986 and will involve 650,000 accounts and approximately $600 million in delinquent debts being developed for referral to the IRS for the 1987 tax season. This approach accomplishes two important objectives in our overall plan. First, it affords us an opportunity to gain experience with a new program by referring cases which are least likely to result in disputes. Second, we will avoid an overload of VA collection resources by systematically notifying the remaining 650,000 debtors early enough in 1986 that we can fully resolve disputes well in advance of actual referrals to the IRS in late 1986. An additional advantage to this plan is that there should be few additional costs incurred as we integrate tax refund offsets with other debt collection initiatives. There will, of course, be nominal costs for the direct mailing of some 700,000 notices under the two referral phases of our plan. While anticipated benefits are difficult to predict without prior experience, we are optimistic that a significant portion of delinquent debts will be collected in the next 18 months from tax refund offsets and payments received in response to our letters notifying debtors of our intended use of this authority.

(4) What procedures will be followed in handling disputes which may arise concerning these debts, and what redress will be made by the agency in a case where the tax refund offset is made incorrectly?

The VA will follow its normal due process procedures in handling disputes. If a debtor has a valid argument and the debt is questionable, they will be removed from referral status. In the event a tax refund offset is made in error, the Agency will refund the moneys erroneously withheld.

Mr. Chairman, that completes my prepared testimony. We will be pleased to respond to any questions which you and the members of the subcommittee may have.

Chairman PICKLE. All right. We may have questions for you.

The next witness will be Mr. Holloway. Edwin T. Holloway is Associate Administrator for Finance and Investment of the SBA.

STATEMENT OF EDWIN T. HOLLOWAY, ASSOCIATE ADMINISTRATOR FOR FINANCE AND INVESTMENT, U.S. SMALL BUSINESS ADMINISTRATION

Mr. HOLLOWAY. Thank you, Mr. Chairman.

My name is Edwin T. Holloway, and I am the Associate Administrator for Finance and Investment of the Small Business Administration. In the interest of brevity, Mr. Chairman, I am going to skip to page 7 of my statement. The first six pages give a backdrop and a framework for our SBA collection activities.

Chairman PICKLE. That will be agreeable, and all of your statements, gentlemen, will be included in the record.

Mr. HOLLOWAY. Preparatory to proceeding with the tax offset procedure, a general review of the costs and benefits to be attained in targeting our Disaster Home Loans was conducted. Using starting figures 45,000 loans and $125 million outstanding, it was estimated that 40 percent of the loans outstanding would result in no contact or no recovery in view of the 10-year backtracking involved. Assuming 50 percent of the remaining loans will result in an offset averaging $800, SBA would realize almost $11 million from this project. The computer processing cost to accomplish this exercise was established at approximately $63,000. Personnel and other administrative costs are estimated at $60,000. The combination of these expenses establishes the total cost of the effort at ap-

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proximately $123,000. This amount deducted from the estimated recovery results in a net dollar benefit to the government of more than $10 million resulting from the IRS tax refund offset of the past due SBA loans involved.

SBA has taken a variety of steps to bring this project to fruition. After several meetings between representatives of the Office of Management and Budget, the Internal Revenue Service, and the Small Business Administration, and other involved agencies, a general sense of the intent of the legislation was established among the parties and a general understanding of the capabilities of their respective equipment and other resources was accomplished. A test computer tape containing the bulk of the SBA obligors was provided to IRS for compatability testing in June 1985. Several adjustments have been made by data processing personnel since that time to assure effective computer-to-computer matching. A notification letter was developed and is now in printing for use in notifying the affected obligors. The Agency's billing process was also adjusted to accommodate a special bill for accounts in this category and to allow insertion of the special notification letter. Legal counsel's review of IRS draft rules and regulations lead to the determination that the affected agencies could proceed based on the IRS publication of specific rules and regulations for this purpose.

It is intended that SBA will accomplish a mass mailing during the first week in October 1985 to all affected obligors advising of the Agency's intent to offset and of the administrative remedies available to them. A copy of the letter notice is attached as exhibit 1 to my statement. A single contact point was established within SBA to receive written requests for administrative review and disputes. All obligors who so contest the Agency's determination regarding the status of their account will be immediately removed from the offset list until an administrative review can be conducted. All such reviews will be conducted within local field offices by personnel familiar with the conditions locally and with the full availability of the file and other background information on the loan. In late December 1985, a computer tape of those remaining obligors, of nondisputed accounts, will be provided to the Internal Revenue Service. IRS advises that they will proceed with the offset process in early January 1986. During this period, IRS will provide the same obligors with a statement of the IRS procedures and how they work. Obligors who wish to protest the amount of the offset, or the appropriateness thereof, may do so to IRS as well as to SBA and we will inter-react. Included in the process is an ability to refund any amounts taken in excess of that proven to be due or to adjust for unusual situations which may arise. For instance, if an obligor were divorced and remarried and filed a joint return, the new spouse would have no obligation on the SBA loan. Accordingly, IRS procedures would allow for an identification of such a situation for return of that portion of the amount offset due to the nonobligated spouse.

IRS will deposit all moneys received and advise SBA by computer listing of the funds applicable on a loan-by-loan basis. SBA will take steps to credit each such account with the moneys received.

All in all, a good deal of thought and planning have gone into the development of this legislatively supported initiative. Our

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sample testing indicates that a considerable number of obligors with ability to repay their SBA debt exists within the universe of borrowers involved. Basic costs totaling roughly $125,000 and the net recovery is conservatively estimated in excess of $10 million. IRS has had experience with similar processes on other program activities during the last 3 years, and it appears that they now have a reasonably effective and dependable system for accomplishing this task. Sincere efforts have been made to assure that checks and balances are in place and that appropriate recourse is available to remedy any situation where a tax refund offset may be made incorrectly.

We anticipate that this system will be implemented smoothly, effectively, and fairly. We recognize that this is only one of the initiatives made available by the Deficit Reduction Act of 1984. Developmental efforts are underway to effectuate several other of the initiatives contained in that legislation in order to assure to the fullest extent possible that the intent of Congress to help reduce the Nation's present deficit situation incorporates to the fullest extent possible actions to assure that moneys appropriately due to the government are paid.

Thank you, Mr. Chairman, for your time and attention. I and my staff will be available for further discussions or questions you would like to ask.

[The prepared statement follows:]

STATEMENT OF EDWIN T. HOLLOWAY, ASSOCIATE ADMINISTRATOR FOR FINANCE AND INVESTMENT, U.S. SMALL BUSINESS ADMINISTRATION

Mr. Chairman and members of the subcommittee, my name is Edwin T. Holloway. I am the Associate Administrator for Finance and Investment and I report directly to Administrator Sanders on all matters regarding finance and investment activities. We are here today to provide testimony as to the Small Business Administration's plans for accomplishing offsets of tax refunds due to individuals who are past due on debts owed to the SBA. The Office of Portfolio Management is directly responsible for the development and implementation of this offset procedure. It is organizationally located within the Office of Finance and Investment.

The authority to accomplish a tax refund offset to recover a nontax debt stems from the Deficit Reduction Act of 1984. This legislation authorized Federal agencies to utilize the procedure, in coordination with the Internal Revenue Service, within certain limits and with prior notification to the obligors. In early 1985, the Office of Management and Budget published circular A-129 which strongly encouraged aggressive agency action to accomplish the various initiatives in the aforesaid legislation. Various meetings were conducted by OMB and IRS in participation with the various effected agencies, including the SBA. This planning process has resulted in a computer-supported, cost effective procedure to satisfy the intent of this legislation as efficiently and effectively as possible.

Before we discuss the implementation details of this particular initiative, it is desirable to establish for the subcommittee, the SBA framework for collecting its outstanding debt in order to assume a clear understanding of the context in which we are working.

SBA was established to conduct lending activities in 1952 and has in the 33 years since then developed stronger, more efficient and more effective lending and collection procedures. Charged with solving the basic problem of inadequate term funds available for small businesses by providing government supported lending programs, the agency has always recognized that any prudent lending entity must provide for responsible collection of the debt created. SBA's collection activities are conducted in the more than 100 office locations throughout the country with at least one office in every state. The collection function in these offices is part of the portfolio management activity which specializes in the collection, control, administration and, when necessary, liquidation of the accounts outstanding

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Considerable debt collection emphasis was brought about in the early 1980's which has resulted in major improvements in the agency's collection processes and in its results. The number of delinquent outstanding loans, for instance, has been reduced from approximately 61,000 in September 1981 to 26,644 in August 1985—a reduction of more than half. The size of the portfolio has also been reduced significantly (down more than 160,000 accounts in the last 4 years) as the agency has established a "quality lending" concept and has implemented the more restrictive legislation of the last several years. A primary reason for the improvement is the fact that the agency's collection procedures have experienced a tremendous change during the same period—moving from a file-based, clerical intensive process to a computer-supported automated system. Utilizing the agency's data communication network, which connects each servicing office with the agency's central mainframe in Washinton, a partially automated system was established throughout the Nation in early 1984. The second step in this process was begun in selected "collection center" locations during the last several months and will be nationally effective this fall. This new system is a paperless, state-of-the-art collection approach. New terminals, training tapes and instructions are being made available to all of SBA's servicing offices to assure the success of this important initiative. We would anticipate that with this new system fully effective a significant further reduction in delinquency levels will be accomplished with better controls in place and reduced personnel requirements for the "collection" part of our responsibility.

The establishment of these new processes is accomplishing, as intended, a basic restructuring of our portfolio management function. By applying specialized attention and computer-supported techniques to collection activities, we reduce the personnel requirement for this particular function. The staffing resources made available will be intensively utilized to provide concentrated attention to problem loan resolution. This will, therefore, bring the agency into a posture more beneficial to small business—balanced between effective collection on the one hand and necessary remedial assistance and problem resolution for needy borrowers on the other.

Looking to the future, we anticipate that the computer-supported collection and information systems provided in the last several years will allow the agency, with existing staff, to strike an effective balance between protecting the interest of the Government and assuring to the extent possible the success of our borrower constituency. We fully expect greater successes in both areas throughout the foreseeable future.

The loans SBA has identified for the IRS offset procedure are all severely defaulted disaster home loans. The number to be referred is approximately 45,000 accounts, most of which are in an inactive category with followup action basically suspended. About 20 percent are in liquidation status or are in excess of 180 days past due. The dollar amount outstanding on the accounts to be referred approximates $125 million in the overall. The "inactive" accounts were so categorized during the past 10 years as reflected in the chart below:

DISASTER HOME LOANS SPREAD TO REFLECT YEAR OF REMOVAL FROM ACTIVE STATUS

(Dollar amounts in millions)

	Number of loans	Amounts outstanding
Year inactive		
1977	2,085	$3.6
1978	2,048	4.0
1979	2,213	5.6
1980	2,400	6.7
1981	3,974	8.9
1982	6,431	16.9
1983	8,217	17.4
1984	5,952	14.7
1985 [1]	3,000	9.0
Liquidation [1]	5,000	30.0
180 days plus [1]	4,000	9.6
Total	44,708	124.7

[1] Estimated

These accounts arise from all parts of the Nation but, naturally, are located predominantly in areas where significant disaster activities have occurred. There is, therefore, a concentration of loans of this type in coastal areas resulting from hurricanes and other such effects of nature.

All of these loans arise from the agency's disaster programs designed to assist individuals affected by physical disasters. None are business (commercial) loans—all are considered to be under the category of "consumer" accounts. The average dollar size of these loans is $2,400—most will not exceed $5,000 and some are less than $500. Virtually all of the accounts involved were brought on to the agency's books several years before the year of abeyance. For instance, loans removed from active category in 1982 were typically disbursed by the agency prior to 1980 and were in active collection status at least 2 years—most were being serviced for longer than that.

The agency's collection methods for handling consumer-type accounts have been streamlined and modernized considerably over the past several years. At present, over 70 percent of our portfolio of this type of accounts is being serviced out of four "collection centers" located in New York City; Birmingham, Alabama; El Paso, Texas; and Santa Ana, California. Almost 85 percent of this "consumer" portfolio of 141,403 loans is now current. The collection centers utilize aggressive telephone/letter collection techniques and are almost totally automated. The delinquency rates in the home loan centers have declined repaidly during the past year or so with our most advanced center in Birmingham moving from a delinquency rate in excess of 13 percent in 1983 to only 2.4 percent at present. Santa Ana, similarly, has reduced its outstanding delinquency rate from 14 percent to a present rate of 2.9 percent.

These achievements in collection results are the product of the effort of the last 4 years. Prior to that, the agency was somewhat ineffective in this area since collection followup was not always a priority, or a possibility in some locations. It is clear that a large number of the accounts being referred to IRS for offset did not receive the complete attention of the office involved because of the tremendous increase in workload and the lack of a collection emphasis agencywide.

Collection efforts against samplings of the accounts being referred for offset were conducted at several SBA locations during the last several years. These efforts clearly indicate that considerable recovery potential exists in these loans and that the effectiveness of the agency's collection procedures during the 1970's against home loan borrowers is questionable. Since previous procedures lacked systematic application and the disaster home loans were not addressed in a priority manner, we cannot claim a cost effective collection process for that period. Clearly, the attention of the available staff was distracted to the larger and more compelling commercial accounts in the portfolio. While we feel that these problems have been clearly overcome, it is appropriate that these accounts now be addressed by this newly available, legislatively authorized offset technique to assure that the Government achieves the full collection potential possible.

Notwithstanding the problems in disaster home loan collection in the past, the present collection center concept with its strong priorities, computer-supported systems, and proven private sector techniques is as cost effective, a collection approach as exists in Government or in private industry.

Preparatory to proceeding with the tax offset procedure, a general review of the costs and benefits to be attained in targeting the DLH loans was conducted. Using starting figures 45,000 loans and $125 million outstanding, it was estimated that 40 percent of the loans outstanding would result in no contact or no recovery in view of the 10 year backtracking involved (a relatively long period of time for collection purposes). Assuming 50 percent of the remaining loans will result in an offset averaging $800 (the IRS standard), SBA would realize almost $11 million from this project. The computer processing cost to accomplish this exercise was established at approximately $63,000 (11 man months at $33 per hour plus $5,000 computer time). Personnel and other administrative costs are estimated at $60,000. The combination of these expenses establishes the total cost of the effort at approximately $123,000. This amount deducted from the estimated recovery (gross) results in a net dollar benefit to the Government of more than $10 million resulting from the IRS tax refund offset of the past due SBA loans involved.

SBA has taken a variety of steps to bring this project to fruition. After several meetings between representatives of OMB, IRS, SBA, and other involved agencies, a general sense of the intent of the legislation was established among the parties and a general understanding of the capabilities of their respective equipment and other resources was accomplished. A Test computer tape containing the bulk of the SBA obligors was provided to IRS for compatibility testing in June 1985. Several adjustments have been made by data processing personnel since that time to assure effec-

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tive computer-to-computer matching. A notification letter was developed and is now in printing for use in notifying the effected obligors. The agency's billing process was also adjusted to accommodate a special bill for accounts in this category and to allow insertion of the special notification letter. Legal counsel's review of IRS draft rules and regulations lead to the determination that the effected agencies could proceed based on IRS publication of specific rules and regulations for this purpose.

It is intended that SBA will accomplish a mass mailing during the first week in October 1985 to all effected obligors advising of the agency's intent to offset and of the administrative remedies available to them. A copy of the letter notice is attached as exhibit 1. A single contact point was established within SBA to receive written requests for administrative review and disputes. All obligors who so contest the agency's determination regarding the status of their account will be immediately removed from the offset list until an administrative review can be conducted. All such reviews will be conducted within local field offices by personnel familiar with conditions locally and with full availability of the file and other background information on the loan. In late December 1985, a computer tape of those remaining obligors (non-disputed accounts) will be provided to IRS. IRS advises that they will proceed with the offset process in early January 1986.

During this same period, IRS will provide the same obligors with a statement of the IRS procedures and how they work. Obligors who wish to protest the amount of the offset, or the appropriateness thereof, may do so to IRS as well as to SBA and we will inter-react. Included in the process is an ability to refund any amounts taken in excess of that proven to be due or to adjust for unusual situations which may arise. For instance, if an obligor were divorced and remarried and filed a joint return, the new spouse would have no obligation on the SBA loan. Accordingly, IRS procedures would allow upon identification of such a situation for return of that portion of the amount offset due to the nonobligated spouse.

IRS will deposit all money received and advise SBA by computer listing of the funds applicable on a loan by loan basis. SBA will take steps to credit each such account with the monies received.

All and all a good deal of thought and planning have gone into the development of this legislatively supported initiative. Our sample testing indicates that a considerable number of obligors with ability to repay their SBA debt exists within the universe of borrowers involved. Basic costs total roughly $125,000 and the net recovery is conservatively estimated in excess of $10 million. IRSA has had experience with similar processes on other program activities during the last three years and it appears that they now have a reasonably effective and dependable system for accomplishing this task. Sincere efforts have been made to assure that checks and balances are in place and that appropriate recourse is available to remedy any situation where a tax refund offset may be made incorrectly.

We anticipate that this system will be implemented smoothly, effectively and fairly. We recognize that its only one of the initiatives made available by the Deficit Reduction Act of 1984. Developmental efforts are underway to effectuate several other of the initiatives contained in that legislation in order to assure to the fullest extent possible that the intent of Congress to help reduce the Nation's present deficit situation incorporates to the fullest extent possible actions to assure that monies appropriately due to the Government are paid.

Thank you Mr. Chairman for your time and attention. I and my staff will be available for further discussions or to answer any questions you would like to ask in this important area.

EXHIBIT 1

U.S. SMALL BUSINESS ADMINISTRATION,
OFFICE OF PORTFOLIO MANAGEMENT,
Washington, DC

DEAR BORROWER: This is to notify you that the Small Business Administration (SBA) intends to refer your loan to the Internal Revenue Service (IRS) for collection. Any federal income tax refund to which you may be entitled may be retained in full or partial satisfaction of this obligation. You can avoid this action by forwarding the

total amount due along with the payment coupon in the envelope provided. The amount you owe, including interest to date, and your loan number are shown on the special Repayment Notice enclosed.

You have a right to contest our determination that this past due amount is owed. You may request an administrative review by writing to the following address by December 10, 1985:

Mr. Fred Hanus
Small Business Administration
1441 L Street, NW., Room 814
Washington, DC 20416

If you decide to request administrative review of this determination, please forward any information you have which would tend to show the debt is not past due or is not legally enforceable. You will be notified in writing of the time and place of your administrative review.

Taxpayers who file joint returns will be notified by the IRS at the time of offset regarding the steps to take to protect the share of the refund which may be payable to any spouse who is not obligated for the loan.

Chairman PICKLE. Thank you.

Now, Mr. David Neverman, Acting Deputy Administrator for Financial and Administrative Operations for the Farmers Home Administration, will testify.

Mr. Neverman.

STATEMENT OF DAVID P. NEVERMAN, ACTING DEPUTY ADMINISTRATOR FOR FINANCIAL AND ADMINISTRATIVE OPERATIONS, FARMERS HOME ADMINISTRATION, U.S. DEPARTMENT OF AGRICULTURE

Mr. NEVERMAN. Thank you, Mr. Chairman. I will summarize the prepared statement in the interest of time.

I do appreciate this opportunity to appear before the subcommittee to discuss the Department of Agriculture's proposed pilot project to participate in the IRS income tax refund offset to collect seriously delinquent debts owed to the Farmers Home Administration. In the Department of Agriculture, this provision will be pilot-tested by Farmers Home Administration which will use it to pursue some 25,000 delinquent rural housing debts.

These debts arose from loans made for single-family housing in rural communities, and have been delinquent for more than 6 months.

An additional 1,000 delinquent loans that had been turned over to the Department of Justice for foreclosure will also be sent to the IRS.

In addition to the funds collected directly through this process, we believe that the publicity surrounding this effort will have a positive impact on marginally delinquent borrowers and will provide them with an incentive to bring their accounts current.

The Farmers Home Administration uses more than 1,900 county offices to make and service these loans. Detailed guidance is provided in Farmers Home Administration regulations for the use of such

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authorities as interest credits, moratoriums, and partial payment agreements to help borrowers become successful homeowners. When all of these servicing tools have been used and the borrower is still not making payments in a timely manner, liquidation to protect the Government's interest is considered.

Under this new procedure, borrowers will be given 60 days to demonstrate that Farmers Home information concerning the delinquency is in error and the case should not be transmitted to the Internal Revenue Service. If the Farmers Home Administration agrees with the borrower's statement that the information is in error, the debt will not be referred to IRS.

We anticipate the costs for implementing the tax refund offset program will be minimal.

Based on rough estimates of the financial position of our borrowers, we estimate a recovery of up to $400 per borrower.

The Farmers Home Administration is proud of its loan servicing and collection program, which has helped 96.4 percent of its single-family housing borrowers keep their debts acceptably current. These rural residents are on their way to becoming successful homeowners.

Mr. Chairman, that concludes my prepared remarks, and I will be happy to answer any questions you or the members may have.

[The prepared statement follows:]

STATEMENT OF DAVID P. NEVERMAN, ACTING DEPUTY ADMINISTRATOR FOR FINANCIAL AND ADMINISTRATIVE OPERATIONS, FARMERS HOME ADMINISTRATION, U.S. DEPARTMENT OF AGRICULTURE

Mr. Chairman, I appreciate this opportunity to appear before the subcommittee to discuss the Department's proposed pilot project to participate in implementation of the IRS income tax refund offset to collect seriously delinquent debts owed the Farmers Home Administration under the Rural Housing Program. This program provides loans for housing to low-income rural residents.

The Deficit Reduction Act of 1984 requires Federal agencies to turn over information on seriously delinquent debts to the Internal Revenue Service so that the money can be withheld from debtors' income tax refunds.

In USDA, this provision will be pilot tested by the Farmers Home Administration, which will use it to pursue some 25,000 delinquent rural housing debts.

In addition, we believe that the publicity surrounding this effort will have a positive impact on marginally delinquent borrowers and will provide them with an incentive to bring their accounts current.

The debts arose from loans made for single family housing in rural communities, and have been delinquent for more than 6 months.

An additional 1,000 delinquent loans that had been turned over to the Department of Justice for foreclosure will also be sent to IRS.

The Farmers Home Administration uses more than 1,900 county offices to make and service these loans. Detailed guidance is provided in Farmers Home Administration regulations for use of authorities such as interest credits, moratoriums, and partial payment agreements to help borrowers become successful homeowners.

When all of these servicing tools have been used and the borrower is still not making payments in a timely manner, liquidation to protect the Government's interest is considered.

Field offices are notified each month of delinquent loans, and they are responsible for collecting the debts through letters, visits to the borrower's home, and discussions in the Farmers Home office. In some cases, the borrower may be asked to voluntarily convey the property to Farmers Home to avoid foreclosure action.

We estimate that servicing delinquent single family housing borrowers will cost $10 to $15 million in fiscal year 1985.

Borrowers will be given 60 days to demonstrate that Farmers Home's information concerning the delinquency is in error and the case should not be transmitted to the Internal Revenue Service. If the Farmers Home Administration agrees, the debt will not be referred to IRS.

We anticipate that the costs of implementing the tax refund offset program will be minimal.

Based on estimates of the financial position of our borrowers, we estimate a recovery of up to $400 per borrower. An additional recovery may be achieved from the single family housing debts located at Justice that will be sent to IRS by the Justice Department.

The Farmers Home Administration is proud of its loan servicing and collection program, which has helped 96.4 percent of its single family housing borrowers keep their debts acceptably current. These rural residents are on their way to becoming successful homeowners.

Chairman PICKLE. Well, we thank all of you, and we appreciate your statements. All of them will be included in the record, and the staff and the members will be examining more fully some of the material included in your statements.

Now, let me make an overall, general appraisal. First, what possibility do you have—in the absence of a refund being claimed—of collecting these bad debts? If there is no refund being claimed, would you have any way to get at these people, get collections?

[Pause.]

Chairman PICKLE. Do you understand the question?

Mr. HOLLOWAY. Yes, sir, I understand the question. And I might say that we have two rather large categories in our debt collection efforts, and that is the area of servicing loans and the area of liquidation of loans, for those most seriously defaulted accounts. And it is loans that have gone all the way through the servicing attempts, all the way through the liquidation attempts, and have been, in the case of our pilot program here, charged off within the past 10 years, after the exhaustion of all collection efforts. So this is a unique category of accounts for us, in that we are going after money that is in accounts that has already been previously determined that it was uneconomic to continue to pursue collection of those accounts, as charged-off accounts. So it really is about the last resort for this category of accounts in our pilot program.

Chairman PICKLE. I do not want to draw conclusions, but it seems to me like the various agencies involved here have a huge amount of individuals who have not paid their loans or their debts to the Government, and now you are going to seize on this new test program to collect amounts of money that range—on the profit and loss basis—anywhere from a $1 cost to $30, $40 in return.

Why haven't you made those collections earlier? Do each of you think you have an effective collection system now in operation? Do any of you think you have a good collection system in operation?

Mr. HASTINGS. Absolutely.

Mr. MCRAE. Yes.

Chairman PICKLE. Well, then, why do you need the IRS to collect your money?

Mr. HASTINGS. I would like to address that as far as student loans are concerned. As I noted in my remarks, we have been using private collection agencies along with our own resources in the Federal Government, and with the Department of Justice—we have been using Federal employees in a concerted effort since about 1977, and we started using private collection agencies to assist us in 1979, and we have accelerated the number of agencies we are using.

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In addition to that, these notes, which were originally made by a bank or a school—generally before they went into default in most cases—were also serviced by a collection agency before they came to the Department of Education.

There are some people who have temporary circumstances, obviously, who cannot make a payment, and they go into default, even though the law does provide now, particular in the last few years, for the possibility of deferrments or deferrals in order to help them over temporary periods of unemployment or illness.

There appear to be a larger number of people who—in aggregate, however, I would like to stress—are in the very small minority, relative to all people who borrow for student loans, who simply choose for economic reasons or whatever, not to honor their legal and moral obligations.

We have attempted everything we know to get those folks to comply voluntarily. This is the end of the road for most of these cases.

Chairman PICKLE. Mr. Hastings, I noted in your testimony you said that your agency has established a new debt collection agency.

Mr. HASTINGS. Yes, sir. I am the head of it.

Chairman PICKLE. I presume it is to implement this program that is going into effect.

Mr. HASTINGS. Among other things.

Chairman PICKLE. Have you had a debt collection agency previously?

Mr. HASTINGS. Yes, sir.

Chairman PICKLE. Why is the new one different.

Mr. HASTINGS. Weil, I will get to that. The Grace Commission, in their review of the Department of Education, recommended that the Secretary of Education highlight the important functions associated with debt collection, especially in light of the increasing number of loans going into default, primarily as a result of the increased volume of loans being made—there has been a huge increase in the growth of the Guaranteed Loan Program, and the Secretary chose to do that, and I have been appointed to head that department.

Chairman PICKLE. The Secretary, then, implemented this procedure, recommended by the Grace Commission, on his own authority—that is, he took the initiative—or did Congress give him that authority?

Mr. HASTINGS. That is correct.

Chairman PICKLE. The Secretary did.

Mr. HASTINGS. The Secretary did.

Chairman PICKLE. Well, it seems to me like he ought to have done it, anyway, a year or two or several years before. It just looks to me on the surface of the thing that if you have got 1.5 million accounts that are delinquent, and their value is $3 billion, that you have got to question the effectiveness of your program, on the surface of it. It seems to me like it speaks for itself.

Mr. HASTINGS. That may be one interpretation.

Chairman PICKLE. And that is true in most of your agency, it would seem to me. I question whether you have been vigilant enough in collecting these loans. Now, you have responded to that, but it seems to me like much more needs to be desired.

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Mr. HASTINGS. We absolutely agree with you. And what we need to do is to get the message out to the people who today are thinking about defaulting on a loan, that the game is over. And that is exactly what my job is, to get that message across to people who are currently not in the repayment phase on those loans. And there is something like $25 billion worth of guaranteed loans that have been made that have not yet come due for the first payment. And by sending people to credit reporting agencies, by suing people who are employed and clearly have the ability to repay, by using every available tool that we have, including the use of the IRS offset, we expect not only that we are going to collect a significant portion of that money that went into default, but hopefully, to keep those loans from going into default in the first place.

Chairman PICKLE Mr. McGrath.

Mr. MCGRATH. I thank the chairman for yielding.

During my questioning of Commissioner Egger, I referred to the use of private collection agencies. I am wondering how many of your agencies use outside collection agencies. It is unclear to me—at least, this is what was told to me—that there is some lack of clarity as to where the authority to use an outside collection agency, might come from.

I wonder if each of you might respond to that?

Mr. HOLLOWAY. Mr. McGrath, I will respond to that by saying that in our agency, the Small Business Administration, we are very close to pursuing that, in that the General Services Administration has done the procurement to enter a contract that we will be able to use for precisely the purpose that you recite. And we would expect within the next 2 months to be well into that project.

Mr. MCGRATH. Ms. Tardy.

Ms. TARDY. I want to address the chairman's concern about the overall Government effort in debt collection. Our experience is that less than 5 percent of the portfolio of all the loans that HUD insures annually become delinquent Federal obligations. We will refer to IRS less than one-half of this 5 percent. The vast majority of people who have loans under this program are fulfilling their obligations.

I think what you will find is that all agencies are pursuing a number of avenues, and as you have heard here this morning, this really is a last resort. But I think what all of us find, as we try additional efforts, is that when you do that, *x* percent of the people come in and make payments. So it does prove that it is cost effective.

We do salary offsets for Federal employees who have delinquent loans, and when we sent the letters out, telling employees we were going to do this, 12 percent came in and paid off their loans.

We are working with the Defense Department. We have several thousand military employees who have delinquent loans, and we are working out a program with DOD to send letters out to those people.

We are now concentrating on the debtors that probably the private collection companies could not "work." Public or private, efforts reach the point where there is no return forthcoming. We will interject one more effort that will produce a return; otherwise,

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there would have been none. That is why referral to the IRS is a worthwhile thing to do.

No one is relying on this as their major effort for debt collection in their programs at all.

Mr. McGRATH. Do you use an outside private concern?

Ms. TARDY. We did try outside collection agencies 3 years ago. The results were not sufficiently persuasive when compared with the results of our own inhouse efforts. Also, the private companies contacted were not willing to take on all title I accounts, in addition, they expected HUD to continue to operate its debt collection procedures; that is, the automated accounting system, billing, skip-tracing through IRS, and so forth. We ended the pilots and are improving our inhouse collection techniques. For instance, we have the auto-call system, where we have an automated phone calling system, centrally in headquarters. All of our cases are loaded in there through our computer. And you have five people who sit around, and the computer makes the phone calls. If you get a busy signal, it goes on to the next one, it is programmed to go back where a busy signal was. You get somebody, and the case flashes up on the screen, and it says, "Mr. McGrath, you have not made a payment. You are 10 days late." You say, "I will send it in Tuesday." The system automatically records that. Wednesday, you get another phone call that says, "Your check was not received." Using those techniques is as effective as using outside collection agencies.

Mr. McGRATH. Mr. McRae.

Mr. McRAE. Yes, sir. Like Mr. Holloway mentioned, we are in the process of developing a plan that would use private collection agencies, after we have seen the type of contract that the GSA has developed. At this point, we are not in a position to say how we would use private collection, but we intend to consider that as an avenue of collection.

Mr. McGRATH. Thank you, Mr. Chairman.

Chairman PICKLE. Well, I want each agency to respond to my question. HUD said you have a good percentage, 95 percent. Are each of you saying that you have a good, effective collection system now?

Mr. McRAE. Yes, sir.

Mr. HASTINGS. Yes, sir.

Chairman PICKLE. How do we get to those people who are not involved with the refunds? Do you have any percentage to show what amount of money you are or are not collecting from those people where there are no refunds involved?

Mr. McRAE. Yes, sir. At the Veterans' Administration, beginning in November, we will use the authority to refer people to credit reporting agencies. That will be another avenue for us to utilize in our collection efforts.

Overall, our program has shown very good results. As I said in my prepared statement, we have generally collected approximately $6 for every $1 in cost. And of course, the number of debts that are owed to us are a very small number in comparison to the amount of money that we pay out in benefits each year.

It is, as has been stated by others, those that have been reduced to an uncollectable state, where we start using these additional authorities.

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We fully believe that the tax refund offset is a last resort to collect from those people who just have been unwilling to come in and pay, despite our best efforts before. And as I say, our best efforts have created a lot of results.

Chairman PICKLE. Mr. McRae, I appreciate your comment. My question was, do you have any program now to get to these people. Do you have an effective program now in operation to reach those people where an offset is not involved?

Mr. MCRAE. Yes, sir. What we would do if we did not have the offset procedure is to continue to pursue these folks until we are able to reduce them to judgment.

Chairman PICKLE. Let me say this to you and to Mr. Holloway and Mr. Neverman. On the surface of it, you say that you have an effective program. I can appreciate that. And yet, by testimony of all five of you individuals, you have indicated that there are literally millions of loans out, whether it is student loans, veterans loans, housing loans, or small business, that have not been collected.

Now, through this test program, we might be able to reach some of that amount of money through the offset procedure.

It just seems to me like you are inconsistent, when you say you have got a very effective program, and yet, we are going to collect millions and billions of dollars if we put this program into effect.

Now, I can appreciate OMB coming in and saying, "We must have this program. It is the last resort, and we are going to really collect this money." That would be typical of OMB, because you can take pleasure in popping the whip. But it seems to me like you are popping the whip at these people who have not done their jobs.

I have the feeling that the agencies, in big measure, have been sitting on their duffs, waiting for the money to come in, and they have not used any strong methods to do it. Now, I do not want to be critical but that is what we are trying to get at.

I appreciate you telling me how good you are, but at the same time you tell me how good you are, I see millions of cases over here that are stacked up, that have not been paid back. So somebody is not doing their job, or at least, we need to do more. And I am trying to find out how do we do it and still not violate taxpayers' rights as individuals. And that is the concern I have on this committee as a whole.

Now, you can defend that, or you can respond to it if you care to. You are pointing your finger, so I will hear from you, Mr. Holloway.

Mr. HOLLOWAY. Yes, I would like to give one response to that, Mr. Chairman, because I think you have put your finger on a very important point.

In the last four years, for example, the automated, paperless, computer-supported, state-of-the-art systems have made it a new ball game. And that really is what we are looking for in most of this. Ten, fifteen years ago, the productivity increases were not there, the labor-intensiveness of the effort and the resources that could be devoted to this were not adequate. But now—and I know in SBA, we have a computer-supported, automated, paperless, state-of-the-art system that rivals anything available in any other Government agency, and in any private sector company, and we are having great results with that. We are getting only down to a

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very, very small classification of loans that reach back 10 years, and were charged off as uncollectable, in many cases, years ago. And this is the recovery we are getting.

Chairman PICKLE. It may be that the computer age now makes collection a lot more possible than in years past. And I think you make a good point there. I will accept that.

I do say, though, that the agencies have got to assume more responsibility. I know it is difficult to collect money from somebody if they do not want to pay it, or they are dodging it and ducking it, and I do not know how you get blood out of a turnip, in many instances. But neither do I want the agencies to simply let IRS be the big, bad wolf, the fall guy for you.

I do not know whether you have done enough in the past, and I suspect you probably have not—I do not want to make that an accusation, but I sure have that as a suspicion.

Let me recognize Mr. Anthony at this time.

Mr. ANTHONY. Thank you very much, Mr. Chairman.

Since you summarized your statements, rather than reading each one of them, I have not had the ability at this time to read each one of them in detail. I am presently confused as to how much uniformity there exists between the five pilot programs in the five agencies.

I am going to try to ask some questions, and I would like for each of the witnesses to answer, and if it becomes cumbersome in orally answering, maybe we can get these responded to in writing.

I am interested in knowing what the exact percentage of delinquent loans are versus how many are current.

Ms. Tardy, was that number 91 percent or 95 percent that are current?

Ms. TARDY. Ninety-five percent.

Mr. ANTHONY. Ninety-five percent are current. So in your testimony, then, when you mentioned 38 percent were 1 year behind, and 18 percent were 90 days to 1 year behind on a payment schedule, we are talking 38 percent of 5 percent and 18 percent of 5 percent?

Ms. TARDY. Yes, sir; yes, sir.

Mr. ANTHONY. OK, so I was misled about it. Well, that still leaves some missing components of that 5 percent. Could you fill in the blanks there?

Ms. TARDY. The 5 percent is broken down as follows: 44 percent paying; 18 percent delinquent; and 38 percent not paying.

Mr. ANTHONY. That is the 44 percent, then, that are currently on schedule?

Ms. TARDY. Yes, sir.

They are either paying under the full terms of their loan, or they have reached some type of negotiated settlement with us—"I owe $150 a month, but I will pay $85." We say, "Fine."

The only people we are reporting to IRS are those people who will not enter into some kind of an arrangement like that with us and pay. You know, we would take somebody down probably as low as, like, $25 a month. So we are only referring those people who refuse to respond to our letters and our phone calls, saying, "Come in and work out a payment schedule with us."

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Mr. ANTHONY. So, your referrals to IRS are after you have exhausted all of your interagency remedies?

Ms. TARDY. Yes, sir.

Mr. ANTHONY. You have not gone to judgment.

Ms. TARDY. We will not refer accounts which are in bankruptcy or have been turned over to the Department of Justice. Approximately 8 percent of our inventory—5,000 accounts—are subject to a judgment obtained through local U.S. attorneys or have been referred to the Department of Justice.

Mr. ANTHONY. Well, I am still a little bit confused. Let us say you take somebody to judgment. I guess this is really the question I would like to see the whole panel answer. Let's say that you have a case that you have looked and you say, here is a person who is a deadbeat, has the ability to pay, owes a legal debt and a moral obligation to the Federal Government, and we are going to make him pay, both because it is legally due, and it will bring the integrity of the program back up to par.

Who do you use to take that case all the way to judgment?

Ms. TARDY. It is the Justice Department.

Mr. ANTHONY. The Justice Department. Mr. McRae, do you use the Justice Department?

Mr. MCRAE. Yes, sir. We use the Justice Department for those over $1,200, and we use our own attorneys for those between $1,200 and $1,200.

Mr. ANTHONY. So if it is over $1,200, you go to Justice.

Mr. MCRAE. Yes, sir.

Mr. ANTHONY. Do any of the others have an amount limitation?

Ms. TARDY. No.

Mr. HASTINGS. No.

Mr. ANTHONY. Mr. Holloway, do you go to Justice?

Mr. HOLLOWAY. We go to the Justice Department, yes, sir.

Mr. ANTHONY. With an amount limitation?

Mr. HOLLOWAY. No, sir.

Mr. ANTHONY. Mr. Neverman, do you go to Justice?

Mr. NEVERMAN. We also go to Justice, yes.

Mr. ANTHONY. What kind of reaction do you get from Justice? Do they cooperate with you?

Ms. TARDY. I think in our case, it varies across the country, because you are really dealing with the local U.S. attorney's office and the regional offices.

Mr. ANTHONY. Well, I ask that question for a very real reason. I was a prosecuting attorney for 10 years. I would much rather be in the courtroom, trying a first degree murder case and get it on the front page. You try a debt collection case, and it is just not very much fun. I mean, you are forced to sit down and look at somebody eyeball-to-eyeball who is broke, maybe unemployed, married, and their kids are on welfare. I mean, those are tear-jerking cases, and they are not fun, they are not glamorous. And I can see where a district attorney, off someplace, especially if he is living in San Francisco, he might not want to get into those kinds of cases.

So I wish you could document for our Oversight Subcommittee if you have had any particular problems in any particular area, with the Justice Department, because I think this is an equation that we

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also have to look at to see how that particular part of the system works.

Ms. TARDY. I think in fairness, Mr. Anthony, to the Justice Department, we initially had some problems, and our General Counsel has been very responsive in sitting down with Justice. And what has happened in a number of areas is the U.S. attorney's office has delegated back some authority to us to handle cases up to a certain point. And I think we have been able to work out the problems that we have had. But you are right, these are not the highest priority.

Mr. ANTHONY. Well, I guess what I am trying to get to is back to what the chairman asked. Are you exhausting all of these remedies, down through the Justice Department, through judgment, before you come to the IRS for offset? And I think the answer is no, that many of you are bypassing the complete remedies that you have, and you are using IRS someplace else in your priority list.

Am I incorrect in that assumption?

Mr. HASTINGS. We obviously cannot sue everybody in America who is in default on a student loan. We would flood the Federal district courts very quickly. The courts simply cannot handle it.

Mr. ANTHONY. Well, maybe we have got to tell America that there is a problem out there with the court system.

Mr. HASTINGS. Well, we have had testimony before the Congress on the need for additional help in a viable litigative threat as part of our collection efforts. And as I said, there is going to be another hearing next week before Judiciary in the House, as I understand.

Mr. ANTHONY. But you do not feel like you can overload the IRS system, though?

Mr. HASTINGS. This is an extremely different effort as far as I can see, Mr. Anthony. It is virtually a paperless operation; it is all done electronically. We windup with most of the work. The disputes come to us, not to the Internal Revenue Service.

Mr. ANTHONY. Does anybody else want to respond to that general point?

Mr. NEVERMAN. I would like to respond for the Farmers Home Administration. You are correct in that we are not using the IRS refund offset as an absolutely last resort. We are using it for borrowers who are more than 6 months' delinquent. Those are borrowers we consider seriously delinquent. We have already attempted to use every means available to us, but we have not necessarily given up all hope yet. When we do give up all hope of getting the money from that borrower with the means available to us, at that point, we refer it to the Department of Justice. And as I mentioned, in our case, the Department of Justice will be referring some of the cases that we have referred to them to the IRS for offset. So both of us are using it as an additional tool.

Mr. ANTHONY. Mr. Chairman, I just have two more quick questions.

Mr. Hastings, you have reported 16,000 names to the Justice Department.

Mr. HASTINGS. In the last 8 months, yes.

Mr. ANTHONY. Yes. What kind of reaction are you getting from those?

Mr. HASTINGS. I have been trying to get that answer from the Department of Justice, because all I know is how much money I am getting from DOJ sources. We were averaging about $300,000 a month for the first 3 months of this fiscal year, prior to the time we started sending those cases.

We currently are getting about $1 million a month from Justice. Obviously, we are getting some additional money out of the Department of Justice. But I have no idea how many of those cases they have judgments on, and what percentage of them they have been able to satisfy at this point.

Mr. ANTHONY. Well, as you get some data on that, could you forward that on to us?

Mr. HASTINGS. Yes, sir.

Mr. ANTHONY. My last question is, do the moneys collected go into the general fund, or do they go into some agency revolving fund? I would like each one of you to respond.

Ms. TARDY. Our moneys go into the General Treasury.

Mr. HASTINGS. It depends on the program. The national direct student loan moneys which have been referred to us by the schools for collections go back into the general fund. The federally-insured student loan collections go into the student loan insurance fund, which is used to pay the costs of the program.

Mr. MCRAE. The funds collected return to the VA appropriation where the debt was created.

Mr. HOLLOWAY. We have a disaster loan fund, a revolving fund, and the collections go into that.

Mr. NEVERMAN. For Farmers Home, there is a revolving fund, the Rural Housing Insurance Fund, and that is where the collections go.

Mr. ANTHONY. Mr. Chairman, I would just like to close by saying that from time to time, since these legislative matters have come up, I personally have voted for and supported the various programs that these people are now trying to collect debts on.

Your efforts are very critical to the integrity and credibility of those programs out in the hinterlands, I can tell you that. I just want to encourage you to keep doing a good job and work at it and try to improve it. We want to try to work with you so that we can go back and tell the public that the Government is trying to collect a due debt. We are working very hard and very diligently in that manner, so that there will not be the political backlash to want to abolish these particular programs, because they are worthwhile programs.

Ms. TARDY. Mr. Anthony, I would just like to stress, our moneys go back into the FHA fund, which is a Government corporation.

Mr. ANTHONY. Into the——

Ms. TARDY. FHA fund. Federal Housing Administration Fund.

Chairman PICKLE. You people have testified that this is a program that you are implementing as a last resort. Yet, Mr. Neverman, you said that you are making referrals of debts that are no more than, say, 6 months old. And either you or some of the other people who testified indicated that you are making referrals on a 90-day-old collection basis.

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Now, if you are making referrals under this program on that short of time, what kind of collection effort have you really made in 3 months' time or 6 months' time? It sounds to me like you are just grabbing this because it is a good, handy weapon, and bypassing your own efforts, just to throw it off on IRS.

Now, you can respond to that.

Mr. Neverman, you said 6 months. I thought you said 3 months.

Mr. NEVERMAN. We have used 6 months as a threshold. The IRS draft regulations set the threshold at 3 months, and we wanted to go a little further than that.

During that 6 months, or even during the first 3 months, we have a fairly intensive servicing effort. We call the borrower, we write him letters. We have a series of guide letters that our county supervisors use, each one successively stronger. As I mentioned, we have a series of tools we can use to either renegotiate his loan, or accept partial payment. And these are cases where none of those tools have been successful.

Mr. HOLLOWAY. Mr. Chairman, in my statement on page 4, there is a chart breaking out the inactive accounts, and as you will see from that chart, they go back to 1977, 1978, et cetera, on down to accounts that are now in liquidation—that is, they have gone all the way through the servicing and delinquency addressing processes, and are in no case less than 180 days old.

Chairman PICKLE. Who was it that made the statement that you referred cases on a 90-day basis?

Mr. TARDY. I did, Mr. Chairman. At the time the accounts are turned over to HUD, they are seriously delinquent. As I said, 10 days after we get the defaulted note from the lender, we send out our first letter to the borrower. We subsequently send three more letters and attempt to contact the borrower using skip-tracing. We feel that if these efforts are unsuccessful, or we cannot encourage the debtor to establish a replacement plan, there is no reason why they should not be referred.

Chairman PICKLE. Well, I suspect that there is a legitimate reason to raise the question: Is a debt old if it is only 90-days delinquent?

Mr. ANTHONY. Mr. Chairman, would you yield at that point?

Chairman PICKLE. I think a lot of people would say that that is questionable. And if you referred it on that short a basis, no matter whether the statute gives you the right to, I question whether you have really done all you could do to collect that debt.

Ms. TARDY. Mr. Chairman, that is 90 days after the lender has referred it to us. The individual has defaulted with the lender, been delinquent with the lender, and under our program, the lender has certain obligations. He has to go through notices, and sitting down and counseling with this individual, before he can refer the debt back to HUD.

So it has already been through an extensive collection effort, and when we get it the account is an average of 7 months delinquent.

Chairman PICKLE. Mr. Anthony.

Mr. ANTHONY. Thank you, Mr. Chairman.

You all have just thrown so many numbers and figures at us. I am still confused, and I am trying to ascertain, is there a disparity between five pilot programs?

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The numbers I have from an attachment that the staff has made to us shows that the number of loans in thousands for the Department of Agriculture is 37,000; Department of Education is 1,400,000; HUD, 29,000; 44,000 for SBA, and 798 for Veterans. And then it does talk about a dollar volume.

I have divided that out, and it comes to $4,351 as an average for the Department of Agriculture; $1,036 for Department of Education; $5,034 for the Department of Housing and Urban Development. It comes to $19,864 for SBA, which is a far cry from the $48 million that you said that you took to judgment and, as I understood it, 650,000 additional debtors of $600 million in your second phase.

So, if you can correct any misimpression that I have there, I would appreciate that.

[The following was subsequently received from the Department of Agriculture:]

We do not have the staff paper alluded to but the correct figures for USDA are 25,000 accounts with an average principal balance of $25,000 each.

Mr. ANTHONY. And on Veterans' Administration, it drops all the way down to $591 a loan.

Let me tell you what bothers me about this—and I think they are all good collection efforts. But if this $5,000 is a correct number for HUD, and if the offset average is correct, according to Mr. Egger, and if, after 1 year, the taxpayer is educated on an offset, that is going to take you over 10 years of offset to collect, just hitting the average. And if the pilot program that he has been studying translates back over into your program, which I have no doubt it will, then those average numbers are going to fall, which means that the repayment is even going to stretch out, even farther using IRS as an offset to make your debt collections.

That is the reason I keep getting back to what additional efforts have you made, through judgments, through private collections agencies. Am I making any sense with my analysis here?

Ms. TARDY. HUD has 5,000 accounts referred to the Department of Justice and 3,000 Federal civilian and military accounts subject to salary offset. These cases will not be sent to the IRS for offset. It is important, however, to go back to the nature of the individual loans.

We have two basic programs. One is home improvement, and the average loan is 7 to 10 years, and the average amount of the delinquent loan in that portfolio——

Mr. ANTHONY. Which also means that you have a collateral that you can attach and sell—versus an educational loan, which means if that person has nothing—they have already said they have nothing, and that is the reason they want to try to get an education, so they can go out and get something.

So I ask you, why don't you go to a judgment, attach it and sell it, versus Mr. Hastings waiting until the person gets out and gets employed, and then starts working out some long-term payment project?

Ms. TARDY. We are doing that, sir. When we have first liens, we actually initiate foreclosure. If we do not have a first lien, then we do have problems.

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Mr. ANTHONY. Well, somebody has a first lien in this program.

Ms. TARDY. In a lot of cases, it is not HUD on a home improvement; the first lien on their home is their mortgage. It is a home improvement. We are foreclosing where we can.

Mr. ANTHONY. All I am saying is you can force the liquidation, if you are mean enough.

Ms. TARDY. Yes, and we are. That is not where we have our biggest problems. Our biggest problems are the manufactured homes, and that is where you have loans with 12 to 15 years in the term of the note. That is where the average loan amount is twice what it is for the home improvement. Manufactured homes, formerly called mobile homes, are where we have the biggest problem. The mobile homes are repossessed, the people move, and you do not even have a current address. What you do have is a delinquent loan with a 15-year term. Now, we do not expect that the IRS offset will result in a loan being paid in full with a lump-sum payment. All we want is the lender to come in and agree to a repayment schedule to pay off that loan.

Mr. ANTHONY. So to some extent, you are using the IRS offset as an additional tool to get the debtors' attention, and then to go back in and try to work out some other type of repayment schedule?

Ms. TARDY. In some cases we hope to collect the entire debt. In others we will have to settle for repayment plans. You must keep in mind that by the time we send a tax refund offset to the IRS, the debtor has had at least one—usually, more than one—opportunity to enter into a repayment agreement.

Mr. ANTHONY. Are missing accounts a tremendous problem in the 5 percent—in other words, where they pick it up and put it on the back end of a truck and take off?

Ms. TARDY. That is a problem, yes.

Mr. ANTHONY. Do you have the ability to use Social Security numbers as a locater?

Ms. TARDY. Yes, since April 24, 1983, HUD has required Social Security numbers on all credit applications by individuals as a result of the Debt Collection Act of 1982. However, for those accounts where title I loans were originated prior to 1983 and had been assigned to HUD without a borrower's Social Security number, the Department cannot require the debtor to provide his/her Social Security number. As part of the collection process we can send debtors' names and Social Security numbers where we have them to the IRS and learn the most recent addresses they used in filing their tax returns.

A problem we have experienced, and continue to experience, is that HUD has many outstanding loans that were made before 1983 and for which we have no Social Security numbers.

HUD has just established a contact with a private firm to conduct skip-tracing on the 10 to 15 percent of our inventory that are hard-core skips.

Mr. ANTHONY. Do any of the others have problems with missing accounts, in locating them?

Mr. HASTINGS. Skip-tracing, yes.

That is one of the points that I think is so valuable—first of all, we have no intention of letting these things sit after the offset process took place. I mean, we do not intend to go back year after

year to the IRS on these things. One of the valuable things we get out of this process is the tax filing address used for this tax year for everybody that is offset.

Mr. ANTHONY. So that it is a locater service, first of all.

Mr. HASTINGS. We already have the locater service available through IRS.

Ms. TARDY. But we have to have the Social Security number.

Mr. HASTINGS. That is right.

We did a statistical match with IRS for tax year 1983, and 82 percent of the people who were in default on federally—insured student loans and national direct student loans in our data base received a refund that year.

Mr. ANTHONY. How many percent?

Mr. HASTINGS. Eight-two.

Mr. ANTHONY. What is damaging to the program is when they turn out to be doctors, lawyers, and professional baseball players—and Federal employees. I mean, I have an editorial here—I have been just dying to ask you why don't you fire them at HUD if they are delinquent. But I know the real question—if they have a good job, at least you have them located.

Ms. TARDY. Yes. We do not have the authority to fire an employee just because he has a delinquent debt. However, there are no delinquent debtors that are HUD employees.

Mr. ANTHONY. Would the other three agencies make the same comment that Mr. Hastings and Ms. Tardy have said, about some of the intent of using IRS, because I think in just the last 5 minutes, you have certainly cast a different flavor to your testimony as far as I personally am concerned, about what the long-range future potential of this procedure.

Mr. HOLLOWAY. I might say, Congressman, that what we think we are doing over at SBA is participating in a legislatively supported pilot program to determine whether or not this is a viable thing for us to do.

Mr. ANTHONY. Well, don't dump it back on me, now. [Laughter.] You sound like one of my constituents now.

Ms. TARDY. Mr. Anthony, I think one concern you have also is that in our referring these to the IRS, that we are going to say, "Well, now, it IRS's." That is not it at all because while we refer it to IRS, we are still going to be contacting, doing whatever we can do to try to collect that debt. This is just one more way.

Mr. ANTHONY. Let me just close by asking you to do this, if it is not an intolerable burden, and since you have just said that you have got state-of-the-art electronics, I assume that you can push up a few buttons, and it will come right out. You know how many thousands of loans you are going to be referring to IRS for collection. I want to know what percent of those loans have gone to judgment, what percent of those loans have gone through agency notice and attempted to collect, and I want to know what percent have gone to private collection agencies. I am trying to work it all the way down to the bottom. I want to know what percent IRS is being used as a first contact.

Mr. HOLLOWAY. Mr. Anthony, you did make one point earlier about the Justice Department. It is true, and I think it should be recognized, that the Justice Department does find it uneconomic to

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pursue to judgment any case where we cannot show there is collectability. In other words, there must be some assets around somewhere, there must be some collectability, if the Justice Department is going to try to get a judgment. They will not send dollars chasing nickels to get a judgment that is worthless after they get it.

Mr. ANTHONY. It is so simple to get a judgment. I am not buying that argument. I practiced law too long, and I got too many judgments. You can line 100 up one day and run them in there, right and left, and 99 percent of them are not going to even show up. So you are going to run a judgment on them before they even know it, and that judgment lasts a long time, and that judgment is given full faith and credit in their report to the United States.

So, a judgment is one damn good tool to collect this money. And you talk about something showing up on a credit report—a judgment shows up a lot stronger and is more red flag than a 60-day notice letter, followed by three strongly worded letters. You know what happens to the three strongly worded letters? They are never opened; they are thrown in the trash can.

I am still confused between the VA and the $48 million that has gone to judgment and the $600 million; if you could just submit some additional information on that so I can try to make a few calculations.

Mr. MCRAE. Mr. Anthony, I can clarify that now. As I mentioned in my opening statement, the entire $48 million that we are referring to the IRS for the upcoming season has been reduced to judgment, so it has gone through the entire process.

Mr. ANTHONY. So what you are saying is that you have gone all the way through before you have asked IRS to try to do an offset.

Mr. MCRAE. Yes, sir, on this first phase.

Mr. ANTHONY. I understand the first phase.

Mr. MCRAE. I am also saying that beginning the next year, we will then start referring others which have not been reduced to judgment. They will have gone through the entire collection process, been referred to credit reporting agencies, and still no results. We would in effect, as you are hinting at here, then go to the IRS rather than go through the process of judgment.

On a cost benefit basis, we think it is good business to do so.

Mr. ANTHONY. Well, I am just saying, you are going to judgment on your first phase. What if we required the other four agencies to go to judgment on their first phases?

Mr. MCRAE. We have already reduced all of these to judgment. I cannot speak for the other agencies. But for us, what we are trying to do is take a prudent approach to this new program, and that is to take the safest cases first, which are those reduced to judgment.

Mr. ANTHONY. I understand what you are saying. The only thing I am saying is that IRS is going to be collecting a VA loan from you in California that has gone to judgment. They are going to be collecting a student loan in Arkansas that is just going through the administrative process, and that person has not been afforded the equal protections of the court all the way through the system—that is all I am saying—in this pilot project. I think there are some disparities there that we need to have some close oversight on.

Mr. MCRAE. Yes, sir; I would like to clarify something for the record. The Veterans' Administration debts that we will be report-

ing are predominantly not loans. What the other agencies are referring are mostly loans, but ours——

Mr. ANTHONY. You are talking about mistaken benefits that were accrued through some programs.

Mr. MCRAE. What I am referring to is those cases where, for example, a veteran may have been receiving education benefits, and he drops out of school, and neither he nor the school notifies us for several months. Then, when we are notified, we terminate payment, but that does create a debt on his behalf. That debt is referred to our collection process.

Mr. ANTHONY. I yield back the balance of my time, Mr. Chairman.

Chairman PICKLE. Well, when Mr. Anthony had asked the panel earlier whether you have had full cooperation or full effectiveness with the Justice Department, there was a hush from all the witnesses, and finally, Mr. Hastings, I believe it was, ventured to say that he had had some cooperation.

I take it that there has to be an assumption that the Justice Department does not have much enthusiasm for handling your cases and filing suits or seeking judgments, for perhaps various numbers of reasons.

I want to have an answer submitted from each of you about the effectiveness of your contacts with the Justice Department—how many cases have actually been referred, how many have been handled, how many they have dragged their feet on, and that type of information. I think that ought to be taken into consideration.

Mr. ANTHONY. Mr. Chairman, that needs to be broken down by districts, too, and just not as a whole.

Chairman PICKLE. What do you mean by districts?

Mr. ANTHONY. Well, they have got judicial circuits. I think it needs to be broken down by the judicial circuits.

Chairman PICKLE. That is a good point. I am asking for that from you.

[The information follows:]

RESPONSE OF THE SMALL BUSINESS ADMINISTRATION

Question. How effective is the relationship of the Agency with the Department of Justice regarding reducing delinquent accounts to judgment?

Response. The Small Business Administration and the Department of Justice generally work very closely to protect the interest of the Government and collect as many delinquent loan dollars as possible. However, each loan program has unique characteristics. The larger commercial accounts tend to get priority attention over our disaster home loans (consumer debt) which have an average balance of less than $5,000 and, in the majority, are unsecured. The latter are the ones involved in the tax refund offset program.

It is more difficult to prove that "collectibility" exists on such accounts and cost/benefit considerations sometimes negate referral to the Department of Justice. The referral process is sometimes cumbersome and, as a result, the net benefit perceived is not commensurately large. Proof of collectibility was mandated by the Claims Collection Act as a prerequisite to referral to the Department. The intent was that the Government should avoid time-consuming litigation if worthwhile recovery is not clearly apparent. This has come to mean that attachable property must be identified prior to referral to, or acceptance by, a U.S. Attorney. As a result, small loan balances are often not referred if it cannot be proven, in advance, that an attachable judgment (i.e. one which can serve as a lien against identified property) will ensue.

To resolve this problem, SBA and the DOJ have developed two methods which reduce the cost to obtain judgments on small unsecured loans—the use of SBA at-

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torneys designated as *Special Assistant U.S. Attorneys* and the *"batch processing"* of groups of problem loans through litigation.

The Special Assistant U.S. Attorney approach is prevalent in areas of the country where especially good working relationships have been developed between U.S. Attorneys and SBA counsel. In this capacity an SBA attorney can represent SBA in the Federal District Court in the name of the U.S. Attorney. This procedure avoids the paperwork in the formal referral process and provides SBA with good, fast results in smaller accounts. There are about 40 SBA lawyers designated to date.

In the "batch processing" approach, SBA pools very delinquent, small balance, unsecured loans in groups using word processing and assembly line techniques. The paperwork is totally prepared by SBA, and therefore, the U.S. Attorney needs only to sign the summons and complaint for the case to be filed. Filing of 50 to 100 cases at one time is most cost effective and often allows for a joint press release coincident with filing the cases. To date, media coverage has been very positive, and has helped our collectors in dealing with delinquent borrowers.

While we feel good about our relationship overall, we do not have data to reflect jurisdictional judgment activity with the Department of Justice. In our view, the U.S. Attorneys generally do a fine job within the capacities of their individual offices to perform.

[NOTE.—Other agency responses are included in their respective responses to written questions for the record.]

Chairman PICKLE. Each of you have made your estimate of the number of cases that are delinquent, the amount of money that you think you have collected. And staff has given us a preliminary analysis of these numbers. I am going to assume the money that you think you will collect is in reference to the offset procedure only; is that correct? It has nothing to do with the regular default, where there is no offset or refund being asked; is it just with respect to offsets?

Mr. MCRAE. Yes, sir, that is correct. When you take into consideration that offset includes that 60-day notification. A lot of people will, as the gentleman from Education pointed out, call in and say, "I'd like to pay it before you refer it to IRS." In terms of the overall process, yes, sir, your statement is completely correct.

Chairman PICKLE. All right, thank you.

Mr. McGrath.

Mr. MCGRATH. Thank you, Mr. Chairman.

I have no further questions to ask except that I wish to associate myself with the words of Mr. Anthony regarding how your efforts will impact on the public's perception of these programs that your agencies administer.

I can tell you, there is perhaps nothing more retarding for a guy like me to vote for a student loan program, increases in a student loan program or a veterans' program or whatever, than to have an editorial in the daily newspaper showing the outstanding debt of those who have already benefited by some of these loans. So I would encourage you to do all that you can do, in order to keep these collections coming in and to keep the portfolios on those loans at a rate that we and the public can accept. Without it, I am afraid that a lot of the programs that you administer are going to either be frozen or diminished. That would be a shame in the case of those about which some of us feel very strongly.

Chairman PICKLE. Mr. Anthony.

Mr. ANTHONY. Nothing further.

Chairman PICKLE. Well, I want to thank you panelists. The Congress has authorized the test of offset program. That is the law,

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and it will be carried out. It is obvious to me that a great deal needs to be done to collect money that is owed the Government.

I do not want to see the IRS turned into some kind of debt collecting gestapo. They alone should not be the one that has to be the big, mean guy; just as much should be expected from the agencies. And unless the agencies can show that they are doing their proper functions in cooperation with the Justice Department or other agencies of the Government, I think the Congress is going to be concerned with the continuation of this kind of program if we do not feel that good efforts are being made by the agencies.

I do not want to be critical, but on the surface of past experience, it seems to me, because of the huge volume of cases involved, that all at once, we are showing great effectiveness through the use of offsets. I rather doubt we would have collected this money if we did not have the offset program. But it also reveals, it seems to me, a soft spot in our collections agencies. Now, that is a personal feeling, and I sure do not make that as any kind of a finding. But we are going to be sifting through this testimony to try to make that judgment among ourselves, and what we might recommend to our full Ways and Means Committee. I think that is our responsibility.

Meanwhile, I urge you to pursue this program with diligence, because without the continued efforts of the agencies, we then are faced with the proposition that debts owed to the Government may never be repaid. I think this may be a good program for the collection agencies, if they need it. I think to work well it needs the full cooperation of all the agencies.

So I am going to ask that you respond to the various questions we have asked, and other questions that we are going to submit to you in writing, because in the interest of time, we will not try to belabor this issue at this point. But we are going to ask you to get that information back to us. I do not see why you could not get it back within 30 days' time. Is that not reasonable?

Mr. McRAE. That is fine.

Chairman PICKLE. Then, we will ask you to do that and respond to it, and then perhaps we will have another hearing after we get this, and we can sort through it again.

[The following was subsequently received:]

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U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410

OFFICE OF THE ASSISTANT SECRETARY
FOR ADMINISTRATION

RECEIVED
DEC 10 1985
Ways and Means
Subcommittee on Oversight

December 3, 1985

Honorable J. J. Pickle
Chairman, Subcommittee
on Oversight
Committee on Ways and Means
House of Representatives
Washington, DC 20515

Dear Mr. Pickle:

Thank you for your letter of November 13, 1985, in connection with the Subcommittee on Oversight's September 19, 1985, hearing on the "Use of Tax Refund Offsets to Collect Nontax Federal Debts." I have enclosed herewith responses to your questions.

If you have any further questions or if I may be of any further service to the Subcommittee, please advise.

Sincerely,

Judith L. Tardy
Assistant Secretary

Enclosure

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TAX REFUND OFFSET QUESTIONS

1. What is the number of accounts which the agency expects to refer to the Internal Revenue Service for collection through use of a tax refund offset in each of the next 2 years? How many individuals would be affected?

   - o We estimate that 27,000 accounts will be referred each year and that 29,000 individuals will be affected.

2. What is the average size of the loans or debts in default which the agency intends to refer to the Internal Revenue Service for collection through use of a tax refund offset? What range in size of loans would be involved?

   - o $4448.

   - o $100 to $40,000.

3. What is the disposition of money collected through this tax refund offset program? Is the money that is collected by the Internal Revenue Service returned to the Treasury, returned to the agency subject to further appropriation, or kept by the agency as a part of a revolving fund?

   - o The money collected will be transferred by the Internal Revenue Service to the Federal Housing Administration fund, specifically the General Insurance Fund. The individual account of the debtor is credited with the collection.

4. Is the agency currently notifying credit reporting agencies about individuals who fail to repay money they owe the Federal Government? Are there any plans to change your current practice in this regard?

   - o No. However the original lender of these guaranteed notes notified a credit agency as a prerequisite to assigning the note to the Federal Government.

   - o Yes. Debtors will be advised individually of our intention in January 1986. Sixty days later, credit agencies will be notified unless a review requested by the debtor warrants not sending the notice. New delinquencies (notes becoming delinquent after January 1986) will be reported routinely.

5. Is the agency using private debt collection agencies as part of the effort to collect from individuals who have failed to repay money owed to the Federal Government? Are there any plans to change current practice in this regard?

   - o No, other than skip-trace agencies.

   - o Yes. A study of the feasibility of using debt collection agencies to collect Title I loan debt is scheduled for completion during the current fiscal year.

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6. How many of the accounts which the agency intends to refer to the Internal Revenue Service for tax refund offset have been referred to the Department of Justice? How many accounts have been reduced by court action to final judgment? What are the number of cases referred to the Department of Justice and the number of final judgments obtained in the United States District Courts, for each of the Federal Circuits?

   o None.

   o Tax refund offset is an independent remedy with its own due process protections. If judgments are not otherwise collectible, we may refer judgment accounts to the Internal Revenue Service in the future.

7. In addition to the generally applicable Federal statutes and regulations, which internal guidelines does the agency have concerning the amount of debt and length of time a debt must be in default before it can be referred to the Internal Revenue Service for possible tax refund offset? How are you defining default?

   o The debt must be $100 or more and be at least 90 days delinquent.

   o Default is defined as having missed 3 monthly payments.

8. In the case of these defaulted obligations, have any collection attempts been made by other parties, including efforts prior to the agency becoming directly involved? If so, what means were used, and how long was the debt in default before it was referred to the agency?

   o Yes. The original lender exhausted normal commercial, private sector, debt collection efforts before assigning the debt to the Federal Government.

   o The original lender followed accepted commercial practice including notification of credit agencies. The debt was in default 3 to 12 months before being assigned to the Federal Government.

9. Is the agency currently planning to request tax refund offsets against delinquent business accounts? If not, why not, and why are business accounts being treated differently? What is the current number and dollar volume of delinquent business accounts.

   o No.

   o These are consumer debts, not commercial debts. Title I Housing loans are for either home repairs or for the purchase of manufactured (i.e., mobile) homes as prescribed by the National Housing Act.

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10. In the case of an incorrect tax refund offset, is it the agency's responsibility for returning the misappropriated refund to the taxpayer? Is the agency responsible for paying interest under such a circumstance? If so, how would the amount of interest be computed? How long would the individual have to wait for a refund?

    - o Yes.
    - o No. There is no legislative authority for the Department of Housing and Urban Development (HUD) to pay interest.
    - o Once a refund offset was determined to be erroneous, HUD would refund the offset amount immediately.

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Department of Veterans Benefits

Washington D C 2042

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Ways and Means
Subcommittee on Oversight

In Reply Refer To: (201E)

Veterans Administration

NOV 26 1985

Mr. J. J. Pickle, Chairman
Committee on Ways and Means
Subcommittee on Oversight
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

This is response to your letter of November 13, 1985, in reference to the Subcommittee on Oversight's hearing on September 19, 1985, concerning the "Use of Tax Refund Offsets to Collect Nontax Federal Debts". Enclosed is the response to the questions raised by the Subcommittee Members.

If you have any further questions, please advise.

Sincerely yours,

JERRY McRAE
Director, Debt Management Staff

Enclosure

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1. What is the number of accounts which the agency expects to refer to the Internal Revenue Service for collection through use of a tax refund offset in each of the next two years? How many individuals would be affected?

Answer: The Veterans Administration anticipates referring 43,798 accounts in the 1986 IRS TAX Offset Program and we are estimating that approximately 650,000 accounts may be referred for the 1987 program. Approximately 700,000 individuals may be affected by the Federal Income Tax Refund Offset Program for 1986 and 1987.

2. What is the average size of the loans or debts in default which the agency intends to refer to the Internal Revenue Service for collection through use of a tax refund offset? What range in size of loans would be involved?

Answer: The average size of debts which the VA intends to refer to IRS this year is approximately $900. We cannot proficiently indicate the dollar amount for referrals for next year. However, every account over $25 which is eligible for referral will be referred.

3. What is the disposition of money collected through this tax refund offset program? Is the money that is collected by the Internal Revenue Service returned to the Treasury, returned to the agency subject to further appropriation, or kept by the agency as a part of a revolving fund?

Answer: The money collected through the Federal Income Tax Refund Offset program will be applied to interest, administrative cost, court fees, and marshal fees first. These funds will be deposited in a general fund receipt account and returned to Treasury. The balance of the money remaining will be applied to the principal amount of the debt. These funds will be distributed according to the type of debt referred. The money collected for Education, Compensation, and Pension debts will be deposited in the appropriate account for reappropriation. The money collected for Loan Guaranty debts will be deposited in a direct loan appropriation which is a revolving fund account.

4. Is the agency currently notifying credit reporting agencies about individuals who fail to repay money they owe the Federal Government? Are there any plans to change your current practice in this regard?

Answer: The Veterans Administration is currently notifying credit reporting agencies about individuals who fail to repay their outstanding debts. At this time, there are no plans to change our current practice in this regard.

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5. Is the agency using private debt collection agencies as part of the effort to collect from individuals who have failed to repay money owed to the Federal government? Are there any plans to change current practice in this regard?

Answer: The VA is not using private debt collection agencies as part of the effort to collect from individuals. The Agency has not yet made a final determination as to the use of private collection agencies in the collection effort.

6. How many of the accounts which the agency intends to refer to the Internal Revenue Service for tax refund offset have been referred to the Department of Justice? How many accounts have been reduced by court action to final judgment? What are the number of cases referred to the Department of Justice and the number of final judgments obtained in the United States District Courts, for each of the Federal Circuits?

Answer: Of the estimated 43,798 accounts the Veterans Administration may be referring for the 1986 Tax Refund Offset Program, 8,364 are Department of Justice accounts and 35,434 are United States District Courts accounts. All accounts being referred for the 1986 Tax Refund Offset Program have been reduced to judgment. The information regarding the number of cases referred and the number of final judgments obtained in United States District Courts for each of the Federal Circuits is not available.

7. In addition to the generally applicable Federal statutes and regulations, which internal guidelines does the agency have concerning the amount of debt and length of time a debt must be in default before it can be referred to the Internal Revenue Service for possible tax refund offset? How are you defining default?

Answer: The Veterans Administration has not published any internal guidelines concerning the amount of the debt and the length of time it must be in default before being referred to IRS. We are following the guidelines published in 26 CFR Part 301 which was issued by Internal Revenue Service. This Agency defines default as any debt that is more than 30 days delinquent.

8. In the case of these defaulted obligations, have any collection attempts been made by other parties, including efforts prior to the agency becoming directly involved? If so, what means were used, and how long was the debt in default before it was referred to the agency?

Answer: The Veterans Administration has not referred defaulted obligations to any other parties for collection attempts.

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3.

9. Is the agency currently planning to request tax refund offsets against delinquent business accounts? If not, why not, and why are business accounts being treated differently? What is the current number and dollar volume of delinquent business accounts?

Answer: There are no current plans to request tax refund offsets against delinquent business accounts. The Veterans Administration's outstanding business accounts are small in relation to benefit overpayments and the records are not presently in an automated system. Therefore, a manual referral system would have to be developed and based on volume, this is not practical at this time. The current number and dollar volume of delinquent business accounts are not available.

10. In the case of an incorrect tax refund offset, is it the agency's responsibility for returning the misappropriated refund to the taxpayer? Is the agency responsible for paying interest under such a circumstance? If so, how would the amount of interest be computed? How long would the individual have to wait for a refund?

Answer: In the case of an incorrect tax refund offset, the Veterans Administration will refund the misappropriated tax offset funds to the debtor. We are aware of no regulation that requires the agencies to pay interest under such a circumstance. It will take approximately two weeks for the VA to refund the individual.

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U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

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Ways and Means
Subcommittee on Oversight

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Honorable J.J. Pickle
Chairman
Subcommittee on Oversight
Committee on Ways and Means
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

This letter is in response to your letter of November 13, addressed to Mr. Edwin T. Holloway, in which you requested the Small Business Administration to respond to additional questions your Subcommittee has in connection with the hearing of September 19, on the "Use of the Tax Refund Offset to Collect Nontax Federal Debts."

Enclosed you will find our response to the questions raised at the hearing. We are pleased to have been provided with the opportunity to appear on this issue.

Sincerely yours,

Richard T. Nelson

Richard T. Nelson
Assistant Administrator for
Congressional and Legislative Affairs

Enclosure

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TAX REFUND OFFSET QUESTIONS

Question 1: What is the number of accounts which the Agency expects to refer to the Internal Revenue Service for collection through use of a tax refund offset in each of the next two years? How many individuals would be affected?

Response: The Agency presently has 44,708 loans with outstanding balances totaling $124.7 million in the IRS Refund Offset Program. We anticipate that after payouts, workouts and adjustments, the number actually referred for offset will be approximately 40,000. Since many of these accounts involve a married couple, we would anticipate that approximately 60,000 individuals are affected. We anticipate that the amounts which will be referred next year would be somewhat the same. Many would, of course, be the same ones affected this year.

Question 2: What is the average size of the loans or debts in default which the Agency intends to refer to the Internal Revenue Service for collection through use of a tax refund offset? What range in size of loans would be involved?

Response: The average size of the loans in the Tax Refund Offset Project is $2,400. They range in size from $25 to approximately $50,000.

Question 3: What is the disposition of money collected through this tax refund offset program? Is the money that is collected by the Internal Revenue Service returned to the Treasury, returned to the Agency subject to further appropriation, or kept by the Agency as a part of a revolving fund?

Response: All funds collected through the Tax Refund Offset Program will be returned to the Agency's Disaster Loan Revolving Fund.

Question 4: Is the Agency currently notifying credit reporting agencies about individuals who fail to repay money they owe the Federal Government? Are there any plans to change your current practice in this regard?

Response: SBA does not yet report individual "consumer" debtors to credit reporting agencies. However, the Agency has signed contracts with such agencies and we expect to begin doing so within FY 1986. Unresolved accounts in the Tax Refund Offset Program are expected to be the first such reporting by SBA. SBA does report all commercial accounts to commercial reporting agencies on a quarterly basis regardless of status.

Question 5: Is the Agency using private debt collection agencies as part of the effort to collect from individuals who have failed to repay money owed to the Federal Government? Are there any plans to change current practice in this regard?

Response: SBA has become a party to the recently established contracts negotiated by GSA with several collection firms. We anticipate that initial referral of accounts for such collection services will take place within the next six months.

Question 6: How many of the accounts which the Agency intends to refer to the Internal Revenue Service for tax refund offset have been referred to the Department of Justice? How many accounts have been reduced by court action to final judgment? What are the number of cases referred to the Department of Justice and the number of final judgments obtained in the United States District Courts, for each of the Federal Circuits?

Response: Requirements of the Department of Justice necessitate that accounts be in excess of $500 and the referring agency, in accordance with the Claims Collection Act, must identify clear collectibility of such accounts before referral. The large majority of the accounts in the class of loans in the Tax Refund Offset Program are unsecured and most of the individuals do not have reachable assets although many do have jobs and are making payments to other creditors. Since attachable properties cannot be identified, most have not been referred for judgment action by the Department of Justice. We do not have any definitive figures but would estimate that approximately 20% have been reduced to judgments and an additional 10% are in the hands of United States Attorneys nationwide. We have no information as to the number of judgments obtained within individual Federal Circuits.

Question 7: In addition to the generally applicable Federal statutes and regulations, which internal guidelines does the agency have concerning the amount of debt and length of time a debt must be in default before it can be referred to the Internal Revenue Service for possible tax refund offset? How are you defining default?

Response: In addition to the foregoing material, the Agency has had considerable coordination with IRS and with OMB regarding the general procedural handling of this project. The types of loans to be included and the referral procedures necessary to assure appropriate level of uniformity between the various agencies involved are reflected in letters, Memorandums of Understanding and the like. In the case of SBA, we are sending all accounts in "charged-off" status or in "liquidation" process or "past due more than six months". For purposes of this project, "default" would encompass these three categories.

Question 8: In the case of these defaulted obligations, have any collection attempts been made by other parties, including efforts prior to the agency becoming directly involved? If so, what means were used, and how long was the debt in default before it was referred to the agency?

Response: All of the accounts in the IRS Refund Offset Project were made "directly" by SBA to the recipient and all have been SBA-serviced since their inception.

Question 9: Is the agency currently planning to request tax refund offsets against delinquent business accounts? If not, why not, and why are business accounts being treated differently? What is the current number and dollar volume of delinquent business accounts?

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Response: For this cycle the Agency has determined that only consumer-type accounts will be included in the project. Such accounts have more inherent similarities than commercial accounts and are therefore more easily handled in a computer supported environment. The variables involved in commercial accounts are substantial starting with the form of business (i.e. corporate, partnership, proprietorship) onward to the various industrial classifications. It is also apparent that most small businesses in difficulty will not have a tax refund due since taxes will not be due in the face of losses. Finally, and most importantly, the Agency's computer record does not contain Social Security numbers on the guarantors of commercial accounts which would necessitate a major manual effort on the part of all SBA field offices to develop the basic data with which to begin. We have therefore preferred to utilize this special offset procedure for those accounts which have, in our view, a clear cost/benefit relationship. We are also advised that the IRS computer process now in place does not have the capacity to handle commercial accounts. The Agency presently has approximately 25,000 business loans in a delinquent or liquidation condition.

Question 10: In the case of an incorrect tax refund offset, is it the agency's responsibility for returning the misappropriated refund to the taxpayer? Is the agency responsible for paying interest under such a circumstance? If so, how would the amount of interest be computed? How long would the individual have to wait for a refund?

Response: If the incorrect offset occurred as a result of an "injured spouse" situation, the IRS will make the review and return the funds as appropriate. All other incorrect offset situations would be the responsibility of the referring agency which would review the evidence presented and make refunds as appropriate. We would anticipate that a review and refund would be possible within 20 working days of receipt of the claim and necessary supporting data. We have no present procedure for paying interest in such situations since we expect that the number of such cases will be limited and the amounts involved to be relatively small. We also understand that interest on tax refunds does not accrue until after June 30 - a point at which this project should be substantially completed.

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United States Department of Agriculture | Farmers Home Administration | Washington D.C. 20250

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Ways and Means
Subcommittee on Oversight

Honorable J. J. Pickle, Chairman
Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

This is in response to your letter of November 13, 1985, requesting additional information concerning Internal Revenue Service (IRS) offset as implemented by the Farmers Home Administration (FmHA).

1. What is the number of accounts which the agency expects to refer to the Internal Revenue Service for collection through use of a tax refund offset in each of the next two years? How many individuals would be affected?

For tax year 1985, only Single Family Housing borrowers who are more than 6 months delinquent will be reported. We have identified a potential total of 25,000 borrowers, but the actual number will be determined after the 60 days have passed in which borrowers, responding to their original notification, present arguments that they should not be included in the IRS offset program. At least the same number is expected for 1986.

2. What is the average size of the loans or debts in default which the agency intends to refer to the Internal Revenue Service for collection through use of a tax refund offset? What range in size of loans would be involved?

The average amount of unpaid principal remaining on loans to be referred to the IRS for offset is approximately $25,000. The range could be from a few thousand dollars to about $40,000.

3. What is the disposition of money collected through this tax refund offset program? Is the money that is collected by the Internal Revenue Service returned to the Treasury, returned to the agency subject to further appropriation, or kept by the agency as a part of a revolving fund?

Funds collected through the tax refund offset program will be sent by the IRS to the Farmers Home Administration and credited to borrowers' accounts. Collections will then be placed in the Rural Housing Insurance revolving fund.

4. Is the agency currently notifying credit reporting agencies about individuals who fail to repay money they owe the Federal Government? Are there any plans to change your current practice in this regard?

FmHA is implementing a program to report delinquent consumer borrowers to credit bureaus. The pilot program will begin in March 1986 and involve 15 of FmHA's local offices. Full nationwide implementation will begin in 1987.

FmHA

Honorable J. J. Pickle

5. Is the agency using private debt collection agencies as part of the effort to collect from individuals who have failed to repay money owed to the Federal Government? Are there any plans to change current practice in this regard?

FmHA is studying the referral of certain accounts to collection agencies as a result of the recently awarded GSA contract for such services. A pilot program using contractors to service housing accounts and receive payments is underway in Puerto Rico and is being expanded to South Carolina. After these pilots are fully evaluated, this program may be expanded to other locations.

6. How many of the accounts which the agency intends to refer to the Internal Revenue Service for tax refund offset have been referred to the Department of Justice? How many accounts have been reduced by court action to final judgment? What are the number of cases referred to the Department of Justice and the number of final judgments obtained in the United States District Courts, for each of the Federal Circuits?

FmHA will not refer to the IRS accounts which have been referred to the Department of Justice. The Justice Department itself will be referring approximately 1,000 FmHA cases to the IRS. FmHA does not have the precise number of cases referred to the Department of Justice and the number of final judgments obtained in the U.S. District Courts, but is working with the Department of Justice to obtain that information. We will forward that information to you as soon as it is available.

7. In addition to the generally applicable Federal statutes and regulations, which internal guidelines does the agency have concerning the amount of debt and length of time a debt must be in default before it can be referred to the Internal Revenue Service for possible tax refund offset? How are you defining default?

Before an account can be referred to the Internal Revenue Service for tax refund offset, the account must be at least 181 days or 6 months delinquent and the amount of delinquency must be greater than or equal to $50.00. Default is defined as delinquency.

8. In the case of these defaulted obligations, have any collection attempts been made by other parties, including efforts prior to the agency becoming directly involved? If so, what means were used, and how long was the debt in default before it was referred to the agency?

All loans referred to the Internal Revenue Service for tax refund offset were made and serviced by FmHA. All prior collection efforts were made by the Agency (except for certain cases in Puerto Rico serviced by contractor under the pilot referred to in question 5 above).

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Honorable J. J. Pickle

9. Is the agency currently planning to request tax refund offsets against delinquent business accounts? If not, why not, and why are business accounts being treated differently? What is the current number and dollar volume of delinquent business accounts?

No, FmHA is not planning to request tax refund offsets against delinquent business accounts in 1985. We understand that IRS does not have the capability to process offsets on business returns. Because the IRS offset program was intended by law to be only a limited pilot test, only one of FmHA's major programs was selected for inclusion.

10. In the case of an incorrect tax refund offset, is it the agency's responsibility for returning the misappropriated refund to the taxpayer? Is the agency responsible for paying interest under such a circumstance? If so, how would the amount of interest be computed? How long would the individual have to wait for a refund?

In the case of an incorrect offset, FmHA will return the misappropriated refund to the borrower. FmHA does not have legislative authority to pay interest on such refunds. All refunds will be made promptly.

Please let us know if we can be of further assistance.

Sincerely,

DAVID NEVERMAN
Assistant Administrator for
Planning, Budgeting, and Finance

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UNITED STATES DEPARTMENT OF EDUCATION
WASHINGTON DC 20202

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Ways and Means
Subcommittee on Oversight

JAN 15 1986

Honorable J.J. Pickle, Chairman
Committee on Ways and Means
Subcommittee on Oversight
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Pickle:

Enclosed are responses to the questions raised by members of your subcommittee which were not addressed in my testimony during the hearing on the "Use of Tax Refund Offsets to Collect Nontax Federal Debts." My understanding is that these questions and answers will also be included in the official record of the hearing.

In my testimony on September 19, I advised the subcommittee members of the Department's expectations given the information available to it at that time. Since the hearing, the Department and IRS have been working diligently to ensure the success of the offset. In the process we have received additional information and have revised our expectations. I am taking this opportunity to provide you with our latest estimates of recoveries in 1986 resulting from participation in the tax refund offset program.

My testimony indicated that we expected to forward 1.5 million accounts to IRS. Based on the actual level of participation by the guarantee agencies, which is much lower than originally anticipated, and recent IRS test data on our loans we reduced our estimate to 675,000 accounts.

In December, IRS provided the Department of Education with the following information based on an analysis of 800,000 student loan accounts possibly eligible for offset. The analysis did not include guarantee agency accounts, because the Department had not been provided specific account level information at the time the analysis was performed. The data provided by IRS are based on a match of the Federally Insured Student Loan (FISL) and the National Direct Student Loan (NDSL) accounts referred to IRS for pre-offset processing. They are virtually the same accounts which will be certified for offset in January (less the guarantee agency accounts). IRS matched these accounts against its records for taxpayers who filed tax returns during 1985. IRS found that of approximately 800,000 accounts which ED pre-certified to IRS, 472,000 passed the IRS edits for age (less than 10 years old) and social security numbers (SSN must be logical and must match name provided by IRS and SSA). The analysis revealed that 365,000 of these accounts matched the IRS Individual Master File (IMF) which contains a record of every taxpayer who has paid income taxes at least once. IRS found that 285,000 of these taxpayers filed a return in 1985 and 166,000 received refunds. The amount

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which could have been offset on our accounts totalled $84 million, an average of $506 per account. Based on IRS' findings for FISL/NDSL 1985 refunds, we estimated that 175,000 GSL accounts from guarantee agencies would have passed the IRS edits; 133,000 would have matched the IMF, and approximately 63,000 GSL debtors would have had refunds offset in 1985 for $31 million.

Considering the 657,000 accounts we actually certified on January 7 and the results of the December analysis we have reduced the preliminary estimate of $250 million expected recoveries for the first year of the offset program to the current $112 million.

If future events cause the Department to revise its estimates significantly, you will be advised. If you feel additional information is necessary, please call on me.

Sincerely,

Richard A. Hastings
Director
Debt Collection and
Management Assistance Service

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1. Q. - What is the number of accounts which the agency expects to refer to the Internal Revenue Service for collection through use of a tax refund offset in each of the next two years? How many individuals would be affected?

   A. - On January 7 ED referred 657,694 accounts, valued at $1,320,648,760 to IRS. These referrals included 244,886 Federally Insured Student Loan (FISL) accounts, 220,210 National Direct Student Loan (NDSL) accounts and 192,598 Guaranteed Student Loan (GSL) accounts.

   A recent analysis conducted by IRS using information on 1984 tax refunds, revealed that 166,000 FISL/NDSL borrowers would have been offset. By applying the same ratio to GSL accounts certified to IRS we estimate 63,000 will be offset.

   There are many factors which could significantly affect the number of accounts which will be referred in 1987. However, at the present time, we are estimating that circumstances will remain the same and the number of refunds will be similar to 1986.

2. Q. - What is the average size of the loans or debts in default which the agency intends to refer to the Internal Revenue Service for collection through use of a tax refund offset? What range in size of loans would be involved?

   A. - The average size of the loans in default referred to the Internal Revenue Service for refund offset were:

   - FISL - $2,112
   - NDSL - $1,062
   - GSL - $2,958

   - The range of outstanding debts is estimated to be:

   $ 25 - $15,700

3. Q. - What is the disposition of money collected through this tax refund offset program? Is the money that is collected by the Internal Revenue Service returned to the Treasury, returned to the agency subject to further appropriation, or kept by the agency as a part of a revolving fund?

   A. - Amounts recovered on debts under the FISL and GSL programs will be returned to the Department for deposit into the Student Loan Insurance Fund which is used to pay default claims, interest and special allowance.

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The deposit of collected monies to this fund will reduce the need for supplemental appropriation requests in the future.

Under current requirements, the funds collected on the NDSL debts will be deposited in the U.S. Treasury. However, provisions of the Student Loan Collection Improvement Amendments of 1985 (H.R. 3700, sponsored by the Honorable William Ford of Michigan) would enable the Department to keep 30% of all monies collected while the other 70% would be reallocated to schools participating in the program.

4. Q. - Is the agency currently notifying credit reporting agencies about individuals who fail to repay money they owe the Federal Government? Are there any plans to change your current practice in this regard?

A. - The Department of Education has been reporting individuals who fail to repay debts owed to the Federal Government since October 1984. Currently, more than 425,000 debtors have been reported within this effort.

The Department has no plans to change the current practice.

In addition, provisions in the Reconciliation Act would, for the first time, require state guarantee agencies to report the names of all borrowers under the GSL program.

5. Q. - Is the agency using private debt collection agencies as part of the effort to collect from individuals who have failed to repay monies owed to the Federal Government? Are there any plans to change current practice in this regard?

A. - The Department of Education has used private collection agencies to assist in debt collection since 1979. Six additional contracts will be implemented in February 1986 with agencies being placed in a competitive environment against each other. The more successful agencies would subsequently receive the larger portion of future referrals.

6. Q. - How many of the accounts which the agency intends to refer to the Internal Revenue Service for tax refund offset have been referred to the Department of Justice? How many accounts have been reduced by court action to final judgment? What are the number of cases referred to the Department of Justice and the number of final judgments obtained in the United States District Courts, for each of the Federal Circuits?

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A. - The Department of Education has, after discussing the pros and cons of such action, chosen not to refer to IRS any of the accounts currently with the Department of Justice because of a lack of valid information from DOJ on the disposition of the accounts.

The Department of Justice is the only source of data on the numbers of cases reduced to judgments obtained in U.S. District Courts, by each U.S. Attorney's District. We expect to receive a report from DOJ shortly on the number of final judgments obtained.

7. Q. - In addition to the generally applicable Federal statutes and regulations, which internal guidelines does the agency have concerning the amount of debt and length of time a debt must be in default before it can be referred to the Internal Revenue Service for possible tax refund offset? How are you defining default?

A. - ED will refer only debts which total $25 or more in outstanding principal balance and have had a 60 day notice mailed to the best address available. For the GSL and FISL programs, default is defined as the failure of a borrower to make an installment payment when due or to meet other terms of the promissory note under circumstances where the Secretary or the pertinent guarantee agency finds it reasonable to conclude that the borrower no longer intends to honor the obligation to repay, provided that his failure persists for -

(a) 120 days for a loan repayable in monthly installments; or

(b) 180 days for a loan repayable in less frequent installments.

For the NDSL program, default is defined as the failure of a borrower to -

(1) Make an installment payment when due, or

(2) Comply with other terms of the promissory note.

However, if the institution reasonably concludes from written contacts with the borrower that he or she intends to repay the loan, the borrower is not considered in default.

8. Q. - In the case of these defaulted obligations, have any collection attempts been made by other parties, including efforts prior to the agency becoming directly

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involved? If so, what means were used, and how long was the debt in default before it was referred to the agency?

A. - All debts referred to IRS which arose from debts in the FISL, NDSL and GSL programs have had school and lender collection efforts, as required by regulation, prior to transfer to the Department.

ED acquires student loan obligations under the FISL program by payment on Federal insurance when the loans have been in default for at least 120 days. ED pays lender claims on Federal insurance only when the lender demonstrates that it has exercised due diligence in attempting to collect the loan, using practices at least as extensive and forceful as those generally practiced by financial institutions for consumer loans.

By statute, the NDSL must have been in default for at least two years prior to transfer to ED. NDSL regulations require schools to exercise due diligence in collecting loans, including mandatory notices to borrowers, use of private collection agencies and, if appropriate, litigation through private attorneys. Due diligence must be exercised and documented prior to acceptance of the debt by ED.

Each guarantee agency acquires student loan obligations under the GSL program by payment on GSL insurance when loans have been in default for at least 120 days. The guarantee agency pays lender claims on GSL insurance only where the lender demonstrates that it has exercised due diligence in attempting to collect the loan using practices at least as extensive and forceful as those generally practiced by financial institutions for consumer loans. ED pays reinsurance claims to the guarantee agencies for up to 100% of the GSL claim payments.

9. Q. - Is the agency currently planning to request tax refund offsets against delinquent business accounts? If not, why not, and why are business accounts being treated differently? What is the current number and dollar volume of delinquent business accounts?

A. - The Department of Education will not be referring any business debts to IRS for offset. IRS has determined that, for 1986, the first year of implementation of the tax refund offset, it will only accept referrals of debts owed by natural persons. The debts owed on student loan obligations include almost all the debts owed to this Department by natural persons.

If the term "business debt" refers to debt owed by parties other than natural persons, that term would encompass debts incurred by state and local government entities, contractors, educational institutions, both nonprofit and for-profit, and other nonprofit organizations participating in ED programs.

Under the Academic Facilities and College Housing loan programs, 76 postsecondary educational institutions are delinquent by a total of $34 million in principal and interest. In addition, 127 other delinquent debts, totalling $9 million, are owed to the Department by educational institutions.

10. Q. - In the case of an incorrect tax refund offset, is it the agency's responsibility for returning the misappropriated refund to the taxpayer? Is the agency responsible for paying interest under such a circumstance? If so, how would the amount of interest be computed? How long would the individual have to wait for a refund?

A. - It is the Department's responsibility for returning misappropriated refunds. There will be at least two primary categories of such incorrect offsets, viz., (1) those cases where the debtor voluntarily pays ED the debt after ED certifies the account to IRS and IRS offsets the refund before ED has time to notify IRS of the voluntary payment, and (2) those cases where the debtor has failed to perform his or her contractual obligation to notify us of a change of address (and therefore failed to receive the 60 day notice) and the debtor has a valid basis to dispute the debt.

This Department is not responsible for paying interest on amounts returned to debtors. Agencies of the United States are not authorized to pay interest on claims unless directed to do so by statute or contractual provisions. No contract governs this aspect of these debts, and the statutory authority for the tax refund offset program, 31 U.S.C. §3720A, does not direct Federal agencies to pay interest on amounts returned to debtors.

Chairman PICKLE. Do any other members have any questions at this time?

Mr. ANTHONY. No further questions.

Mr. MCGRATH. No questions.

Chairman PICKLE. All right. We stand adjourned.

Thank you all very much.

[Whereupon, at 12:15 p.m., the hearing was adjourned.]

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